21ST CENTURY HOLDING CO
Form 10-K
March 16, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x Annual Report under Section 13 or 15(d) of the Securities Act of 1934
For the fiscal year ended December 31, 2006
or
o Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period of _____________to_______________

Commission file number: 0-2500111
21st Century Holding Company
(Exact name of registrant as specified in its Charter)

Florida	65-0248866
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No)

3661 West Oakland Park Boulevard, Suite 300, Lauderdale Lakes, Florida 33311
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (954) 581-9993

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	NASDAQ Global Market, LLC
Redeemable Warrants expiring September 30, 2007	NASDAQ Global Market, LLC

Securities registered pursuant to Section 12(g) of the Exchange Act: None

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See the definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes o No x

The aggregate market value of the Registrant’s common stock held by non-affiliates was $85,440,927 on June 30, 2006, computed on the basis of the closing sale price of the Registrant’s common stock on that date.

As of March 15, 2007, the total number of shares outstanding of Registrant's common stock was 7,959,330.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2007 Annual Meeting of the Shareholders are incorporated by reference into Part III, of this .Form 10K

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PART I

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by words "believes," "project," "expects," "anticipates," "estimates," "intends," "strategy," "plan," "may," "will," "would," "will be," "will continue," "will likely resu expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section entitled "Risk Factors" in Part I, Item 1A of this Annual Report. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1 BUSINESS

GENERAL

21st Century Holding Company ("the 21st Century," "Company," "we," "us") is an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, controls substantially all aspects of the insurance underwriting, distribution and claims process. We are authorized to underwrite homeowners' property and casualty insurance, commercial general liability insurance, and personal automobile insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National Insurance Company ("Federated National") and American Vehicle Insurance Company ("American Vehicle").

Federated National is authorized to underwrite homeowners' property and casualty insurance and personal automobile insurance in Florida as an admitted carrier. American Vehicle is authorized to underwrite personal automobile insurance and commercial general liability coverage in Florida as an admitted carrier. In addition, American Vehicle is authorized to underwrite commercial general liability insurance in Georgia, Kentucky, South Carolina, Virginia, Missouri and Arkansas as a surplus lines carrier and in Texas, Louisiana and Alabama as an admitted carrier. American Vehicle operations in Florida, Georgia, Kentucky, Louisiana, Texas, South Carolina and Virginia are on-going. American Vehicle operations in Alabama, Arkansas and Missouri are expected to begin this year. American Vehicle has an application pending authorization as a surplus lines carrier in the state of California, and applications pending submission to the states of Mississippi and Nevada.

During the year ended December 31, 2006, 74.4%, 21.6%, and 4.0% of the premiums we underwrote were for homeowners' property and casualty insurance, commercial general liability insurance and personal automobile insurance, respectively. During the year ended December 31, 2005, 63.8%, 18.9%, and 17.3% of the premiums we underwrote were for homeowners' property and casualty insurance, commercial general liability insurance and personal automobile insurance, respectively. We internally process claims made by our own and third-party insureds through our wholly owned claims adjusting company, Superior Adjusting, Inc. ("Superior"). We also offer premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc. ("Federated Premium").

Our executive offices are located at 3661 West Oakland Park Boulevard, Suite 300, Lauderdale Lakes, Florida and our telephone number is (954) 581-9993.

Our web site is located at www.21centuryholding.com. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to such reports are available, free of charge, on our website as soon as reasonably practicable after we electronically file or furnish such material with the SEC. Further, a copy of this annual report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

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RECENT DEVELOPMENTS

New Florida Legislation

During an emergency session in January 2007, the Florida legislature passed and the Governor signed into law a bill known as "CS/HB-1A." This new law makes fundamental changes to the property and casualty insurance business in Florida and undertakes a multi-pronged approach to address the cost of residential property insurance in Florida. First, the new law requires insurance companies to lower their Florida premium rates for residential property insurance. The new law also authorizes the state-owned insurance company, Citizens Property Insurance Corporation ("Citizens"),which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance. Previously, Citizens was the insurer of last resort for residential property insurance because its required premium rates were higher than those generally available in the market place from private insurers. The new law also empowers the State of Florida to assess Citizens' underwriting losses against many lines of property and casualty insurance written for Florida residents, including auto insurance. The State of Florida also issued an order that essentially prevents insurance companies from non-renewing residential property insurance policies until after the 2007 hurricane season.

We are evaluating the ramifications of CS/HB-1A, specifically regarding property insurance rates that we believe are inadequate to cover the related underwriting risk. Additionally, we are concerned about competing against a state-owned insurance company. At this time, it is difficult for us to predict the impact of these new legislation in the Florida property and casualty market and we are closely monitoring the situation.

Impact of 2005 -2006 Hurricane Season

From June through October 2005, the State of Florida experienced four hurricanes, Dennis, Katrina, Rita and Wilma. Since then, we have been receiving and processing claims made under our homeowners' and mobile home owners' policies, a process that is expected to continue into the second quarter of 2006. One of the Company's subsidiaries, Federated National, incurred significant losses relative to its homeowners' insurance line of business. As of December 31, 2006, and relative to the 2005 hurricane season, approximately 14,000 policyholders filed hurricane-related claims totaling an estimated $181.2 million, of which we estimate that our share of the costs associated with these hurricanes to be approximately $8.8 million, net of reinsurance recoveries.

For the 2005-2006 hurricane season, the excess of loss treaties insured us for approximately $64.0 million, with the Company retaining the first $3.0 million of loss and loss adjustment expense ("LAE"). The treaties had a one full reinstatement provision for each excess layer with 100% additional premium as to time and pro rata as to amount. In addition, we purchased Reinstatement Premium Protection from the private sector which reimbursed the Company 100% of the cost of reinstatement for the second event. Unused coverage from the first two events carried forward to events beyond the second, in conjunction with a lowered attachment point (as explained below) afforded by the Florida Hurricane Catastrophe Fund ("FHCF").

In addition to the excess of loss reinsurance policies (described above), we continue to participate in the FHCF to protect our interest in the insurable risks associated with our homeowner and mobile home owner insurance products. For the first two events, FHCF coverage begins after the Company's retention of $3.0 million and its excess of loss reinsured retention of approximately $43.0 million.

Maximum coverage afforded from the combined policies of our FHCF and excess of loss policies in effect for varying dates from June 1, 2005 to June 30, 2006 total approximately $194.8 million. FHCF will retain approximately $131.0

million, our excess of loss reinsurance policies will retain $64.0 million, and the Company will retain the first $3 million of insurable losses for two events. For events beyond the second largest catastrophic event during the policy term, FHCF coverage attaches after the Company and its excess of loss reinsured collective retention of approximately $15.0 million. Additionally, unused coverage from our excess of loss reinsurance treaties may be carried forward.

The FHCF treaty provided protection for 90% of losses and LAE and attached at approximately $43.0 million. This treaty inures to the benefit of our excess of loss treaty and expires on June 1, 2006

Impact of 2004 -2005 Hurricane Season

In August and September 2004, the State of Florida experienced four hurricanes, Charley, Frances, Ivan and Jeanne. Since then, we have been receiving and processing claims made under our homeowners' and mobile home owners' policies, a process that is substantially complete. The same subsidiary as noted above, Federated National, incurred significant losses relative to its homeowners' insurance line of business. As of December 31, 2006, and relative to the 2004 hurricane season, approximately 9,000 policyholders filed hurricane-related claims totaling an estimated $143.8 million, of which we estimate that our share of the costs associated with these hurricanes to be approximately $59.4 million, net of reinsurance recoveries.

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We had a reinsurance structure that was a combination of private reinsurance and the FHCF. For each catastrophic occurrence, the excess of loss treaty insured us for $24 million with the Company retaining the first $10 million of losses and LAE. There are two layers involved with our excess of loss reinsurance treaties; the $24 million is considered the first layer. The treaty had a provision which, for an additional prorated premium would insure us for another $24 million of losses and LAE for a subsequent occurrence with the Company retaining the first $10 million in losses and LAE. As a result of the losses and LAE incurred in connection with the Hurricanes Charles and Frances the Company has exhausted its recoveries of $48 million under the terms of this treaty.

The second layer of our excess of loss treaty insures us for an additional $34 million in excess of the $34 million first layer noted above with the same reinstatement provision. The excess of loss treaties expired on June 30, 2005 and the Company negotiated a new reinsurance treaty. Accordingly, losses and LAE incurred for Hurricanes Ivan and Jeanne and any subsequent catastrophic events through June 30, 2005, up to $34 million each, were the responsibility of the Company.

The FHCF treaty provided protection for 90% of losses and LAE and attached at approximately $36.2 million. This treaty inured to the benefit of our excess of loss treaty and expired on June 1, 2005.

For a further discussion of our reinsurance please see our section titled “REINSURANCE”

Regulatory

To retain our certificates of authority, Florida insurance laws and regulations require that our insurance company subsidiaries, Federated National and American Vehicle, maintain capital surplus equal to the greater of 10% of its liabilities or $4.0 million, as defined in the Florida Insurance Code. As of December 31, 2006, Federated National and American Vehicle were in compliance with statutory minimum capital and surplus requirement, as they were as of December 31, 2005.

The insurance companies are also required to adhere to prescribed premium-to-capital surplus ratios. As of December 31, 2006 and 2005, both Federated National and American Vehicle were in compliance with the prescribed premium-to-surplus ratio.

During the aftermath of a catastrophic event, the Florida Office of Insurance Regulation (“OIR”) will routinely issue emergency orders that imposed a moratorium on cancellations and non-renewals of various types of insurance coverage and require mediation to resolve disputes over personal property insurance claims. The orders also prohibit cancellations or non-renewals based solely upon claims resulting from the hurricanes.

BUSINESS STRATEGY

Although recent operations have been dominated in part by the claims made in connection with the nine hurricanes that have occurred during 2004 and 2005, we did return to a focus on the key aspects of our business strategy during 2006. We expect that in 2007 we will seek continued growth of our business by capitalizing on the efficiencies of our business model and by:

- expanding the commercial general liability insurance product into additional states. In addition to our ongoing operations already underway in Florida, Georgia, Kentucky, Louisiana, South Carolina, Texas and Virginia, we have obtained licenses to underwrite and sell commercial general liability insurance in Alabama, Arkansas and Missouri. Although we have not yet begun operation in these states, our operations are expected to begin in 2007;

- a shift in emphasis of our product mix to balance our nonstandard automobile insurance products with our continued emphasis on homeowners' and commercial general liability lines of insurance and by expanding our product offerings to include other insurance products, subject to regulatory approval;

- employing our business practices developed and used in Florida in our expansion to other selected states;

- maintaining a commitment to provide high quality customer service to our agents and insureds;

- encouraging agents to place a high volume of high quality business with us by providing them with attractive commission structures tied to premium levels and loss ratios;

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- additional strategies that may include possible acquisitions or further dispositions of assets, and development of procedures to improve claims history and mitigate losses from claims.

There can be no assurances, however, that any of the foregoing strategies will be developed or successfully implemented or, if implemented, that they will positively affect our results of operations.

INSURANCE OPERATIONS AND RELATED SERVICES

General

We are authorized to underwrite homeowners' property and casualty insurance, commercial general liability insurance, and personal automobile insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National and American Vehicle.

Federated National is authorized to underwrite homeowners' property and casualty insurance and personal automobile insurance in Florida as an admitted carrier. American Vehicle is authorized to underwrite personal automobile insurance and commercial general liability coverage in Florida as an admitted carrier.

In addition, American Vehicle is authorized to underwrite commercial general liability insurance in Arkansas, Georgia, Kentucky, Missouri, South Carolina and Virginia as a surplus lines carrier and in Texas, Louisiana and Alabama as an admitted carrier.

American Vehicle has a pending application in the final stage of an anticipated approval to be authorized as a surplus lines carrier in the state of California.

The following tables set forth the amount and percentages of our gross premiums written, premiums ceded to reinsurers and net premiums written by line of business for the periods indicated.

	Years Ended December 31,					
	2006		2005		2004	
	Premium	Percent	Premium	Percent	Premium	Percent
	(Dollars in Thousands)					
Gross written premiums:						
Automobile	$ 6,064	4.0%	$ 20,665	17.3%	$ 24,239	24.1%
Homeowners'	114,388	74.9%	76,182	63.8%	63,913	63.5%
Commercial General Liability	32,213	21.1%	22,593	18.9%	12,510	12.4%
Total gross written premiums	$ 152,665	100.0%	$ 119,440	100.0%	$ 100,662	100.0%
Ceded premiums:						
Automobile	$ -	0.0%	$ (5)	0.0%	$ (992)	-6.4%
Homeowners'	67,520	100.0%	31,419	100.0%	16,478	106.4%
Commercial General Liability	-	0.0%	-	0.0%	-	0.0%
Total ceded premiums	$ 67,520	100.0%	$ 31,414	100.0%	$ 15,486	100.0%

Net written premiums								
Automobile	$	6,064	7.2%	$	20,670	23.5%	$	25,231	29.6%
Homeowners'		46,868	55.0%		44,763	50.8%		47,435	55.7%
Commercial General Liability		32,213	37.8%		22,593	25.7%		12,510	14.7%
Total net written premiums	$	85,145	100.0%	$	88,026	100.0%	$	85,176	100.0%

We marketed our insurance products through our network of independent agents and general agents in fiscal 2006 and 2005. In fiscal 2004, we also marketed our insurance products through our company owned agencies and franchises, which we sold at the end of fiscal 2004.

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Homeowners' and Mobile Homeowners'

We underwrite homeowners' insurance principally in South and Central Florida. Homeowners' insurance generally protects an owner of real and personal property against covered causes of loss to that property. Limits on homeowners' insurance are generally significantly higher than those for mobile homes, but typically provide for deductibles and other restrictive terms. Our property insurance products typically provide maximum coverage in the amount of $750,000, with the average policy limit being approximately $1,350,000. The approximate average premium on the policies currently in force is approximately $2,727, as compared to $1,849 for 2005, and the typical deductible is $1,000 for non-hurricane-related claims and generally 2% of the coverage amount for the structure for hurricane-related claims.

We underwrite homeowners' insurance for mobile homes, principally in Central and Northern Florida, where we believe that the risk of catastrophe loss from hurricanes in a typical year is less than in other areas of the state. Mobile homeowners' insurance generally involves the potential for above-average loss exposure, as compared to homeowners' insurance. In the absence of major catastrophe losses, however, loss exposure is limited because premiums usually are at higher rates than those charged for non-mobile home property and casualty insurance. Additionally, our property lines for mobile homes typically provide maximum coverage in the amount of $30,000, with the average policy limit being approximately $60,000. In addition, we presently limit our mobile home coverage to no more than 10% of our underwriting exposure. The approximate average premium on the policies currently in force is approximately $334, as compared to $346 for 2005. The typical non-hurricane deductible is $500 and the typical hurricane deductible is 2% of the coverage amount for the structure.

Federated National incurred significant losses relative to its homeowner's and mobile homeowners' insurance lines of business as a result of the three of the five Florida hurricanes in 2005. Approximately 14,010 policyholders have filed hurricane-related claims totaling an estimated $181.2 million, of which we estimate that our share of the costs associated with these hurricanes will be approximately $8.8 million, net of reinsurance recoveries. Federated National also incurred significant losses relative to its homeowner's and mobile homeowners' insurance lines of business as a result of the four Florida hurricanes in 2004. Approximately 9,000 policyholders have filed hurricane-related claims totaling an estimated $155.8 million, of which we estimate that our share of the costs associated with these hurricanes will be approximately $59.4 million, net of reinsurance recoveries. For a further discussion of our reinsurance please see our section titled "REINSURANCE"

Premium rates charged to our property insurance policyholders are continually evaluated to assure that they meet the expectation, that they are actuarially sound and produce a reasonable level of profit (neither excessive nor inadequate). An average rate increase of 14.9% that was implemented effective December 31, 2005 which was followed by an additional increase of 38.3% effective June 1, 2006. Although not yet formally finalized, the 38.3% rate increase was implemented using Florida's "use & file" rate filing provision; the rates have been acknowledged verbally and via e-mail as approved by the State of Florida OIR. Our initial rate increase for policies with an effective date of June 1, 2006 contemplated a 49.9% rate increase, though was ultimately implemented at 38.3%. Policy holders were refunded approximately $6.0 million, and premiums waived totaled and resulted in a charge to operations of approximately $1.0 million.

Effective June 1, 2007 the Windstorm Loss Mitigation discounts will effectively double, which will have an overall average rate reduction effect of 0.5%. Additionally, effective June 1, 2007 the hurricane portion of the wind premium will be reduced by an amount still to be determined in order to comply with the State's legally mandated "presumed factor" rate reduction.

Commercial General Liability

We underwrite commercial general liability insurance for approximately 250 classes of artisan and mercantile trades (excluding home-builders and developers), habitational exposures and certain special events. The limits of liability range from $100,000 per occurrence and $200,000 policy aggregate to $1 million per occurrence and $2 million policy aggregate. We market the commercial general liability insurance products through a limited number of general agencies unaffiliated with the Company. The average annual premium on policies, with deductibles of $250 to $500 per claim, and currently in force is approximately $851, as compared to $763 for the years ended December 31, 2006 and 2005, respectively.

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The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state:

	Years Ended December 31,					
	2006		2005		2004	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)					
State						
Florida	$ 22,965	71.29%	$ 18,293	80.97%	$ 10,727	85.75%
Georgia	1,805	5.60%	1,258	5.57%	793	6.34%
Kentucky	9	0.03%	-	0.00%	-	0.00%
Lousiania	5,743	17.83%	3,042	13.46%	990	7.91%
South Carolina	77	0.24%	-	0.00%	-	0.00%
Texas	1,604	4.98%	-	0.00%	-	0.00%
Virginia	10	0.03%	-	0.00%	-	0.00%
Total	$ 32,213	100.00%	$ 22,593	100.00%	$ 12,510	100.00%

On March 28, 2006 we announced the approval from the OIR to enter into a business relationship with member companies of The Republic Group ("Republic"). This working agreement, in the form of a 100% quota share reinsurance treaty, between the two companies will enable American Vehicle to underwrite general liability business and other commercial lines in various states, on an assumed basis, through affiliates and/or subsidiaries of Republic. Republic has a financial rating of "A-" Excellent with A.M. Best

Under this agreement the Company assumed $22,760 in premiums in connection with its operations in the State of Texas. Operations in Texas began in December 2006.

Personal Automobile

Personal automobile insurance markets can be divided into two categories, standard automobile and nonstandard automobile. Standard personal automobile insurance is principally provided to insureds who present an average risk profile in terms of driving record, vehicle type and other factors. Nonstandard personal automobile insurance is principally provided to insureds that are unable to obtain standard insurance coverage because of their driving record, age, vehicle type or other factors, including market conditions.

Limits on standard personal automobile insurance are generally significantly higher than those for nonstandard coverage, but typically provide for deductibles and other restrictive terms. Underwriting criteria for standard coverage has become more restrictive, thereby requiring more insureds to seek nonstandard coverage and contributing to the increase in the size of the nonstandard automobile market. Nonstandard automobile insurance, however, generally involves the potential for increased loss exposure and higher claims experience. Loss exposure is mitigated because premiums usually are written at higher rates than those written for standard insurance coverage.

Both of our insurance subsidiaries currently underwrite nonstandard personal automobile insurance only in Florida, where the minimum limits are $10,000 per individual, $20,000 per accident for bodily injury, $10,000 per accident for property damage and comprehensive, and $50,000 for collision. The average annual premium on policies currently in force is approximately $860, as compared to $945 for 2005, and the nonstandard personal automobile insurance lines represent approximately 99.8% of our written premiums for personal automobile insurance for both the years ended December 31, 2006 and 2005. Both Federated National and American Vehicle underwrite this coverage on primarily an annual basis and to a much lesser extent, on a semi-annual basis.

Due to the purchasing habits of nonstandard automobile insureds (for example, nonstandard automobile insureds tend to seek the least expensive insurance required of the policyholder by statute that satisfies the requirements of state laws to register a vehicle), policy renewal rates tend to be low compared to standard policies. Our experience has been that a significant number of existing nonstandard policyholders allow their policies to lapse and then reapply for insurance as new policyholders.

Federated National underwrites standard personal automobile insurance policies providing coverage no higher than $100,000 per individual, $300,000 per accident for bodily injury, $50,000 per accident for property damage and comprehensive and collision up to $50,000 per accident, with deductibles ranging from $200 to $1,000. The average premium on the policies currently in force is approximately $1,599, as compared to $1,203 for 2005, and represented approximately 0.2% of our written premiums for personal automobile insurance as of the year ended December 31, 2006. The Company is currently filing for an additional rate increase on the personal automobile line of business.

Flood

We write flood insurance through the National Flood Insurance Program ("NFIP"). We write the policy for the NFIP, which assumes 100% of the flood risk while we retain a commission for our service. The average flood policy premium is approximately $400 with limits up to $250,000. Commissions in connection with this program totaled $0.3 million, $0.2 million and $0.3 million as of December 31, 2006, 2005 and 2004, respectively.

Assurance MGA

Assurance Managing General Agents, Inc. ("Assurance MGA"), a wholly owned subsidiary, acts as Federated National's and American Vehicle's exclusive managing general agent in the state of Florida. As American Vehicle continues its expansion into other states we shall contract with general agents to market our commercial general liability insurance product beyond the state of Florida. Assurance MGA currently provides underwriting policy administration, marketing, accounting and financial services to Federated National and American Vehicle, and participates in the negotiation of reinsurance contracts. Assurance MGA generates revenue through a 6% commission fee from the insurance companies' gross written premium, policy fee income of $25 per policy and other administrative fees from the marketing of company products through the Company's distribution network. The 6% commission fee from Federated National and American Vehicle was made effective January 1, 2005. Assurance MGA plans to establish relationships with additional carriers and add additional insurance products in the future.

Superior

Superior processes claims made by insureds from Federated National, American Vehicle and third-party insurance companies. Our agents have no authority to settle claims or otherwise exercise control over the claims process. Furthermore, we believe that the employment of salaried claims personnel, as opposed to independent adjusters, results in reduced ultimate loss payments, lower LAE and improved customer service for most of our insurance products. Were this not the case, we would retain independent appraisers and adjusters. We also employ an in-house legal department to cost-effectively manage claims-related litigation and to monitor our claims handling practices for efficiency and regulatory compliance.

Federated Premium

Federated Premium provides premium financing to Federated National's, American Vehicle's and third-party's insureds. Premium financing has been marketed through our distribution network of general agencies and a small number of independent agents whose customer base and operational history meets our strict criteria for creditworthiness and, prior to our sale at the end of 2004 of our company-owned and franchised agencies, also through those agencies. Lending operations are primarily supported by Federated Premium's own capital base and currently, to a much lesser extent, through our credit facility with FlatIron Funding Company LLC (Flatiron"), which is described in more detail below.

Premiums for property and casualty insurance are typically payable at the time a policy is placed in force or renewed. Federated Premium's services allow the insured to pay a portion of the premium when the policy is placed in force and the balance in monthly installments over a specified term, generally between six and eight months. As security, Federated Premium retains a contractual right, if a premium installment is not paid when due, to cancel the insurance policy and to receive the unearned premium from the insurer, or in the event of insolvency of an insurer, from the Florida Guarantee Association, subject to a $100 per policy deductible. In the event of cancellation, Federated Premium applies the unearned premium towards the payment obligation of the insured.

The following table sets forth the amount and percentages of premiums financed for Federated National, American Vehicle and other insurers for the periods indicated:

	Years Ended December 31,					
	2006		2005		2004	
	Premium	Percent	Premium	Percent	Premium	Percent
	(Dollars in Thousands)					
Federated National	$ 6,279	56.2%	$ 6,893	21.5%	$ 11,510	34.0%
American Vehicle	1,981	17.7%	14,946	46.7%	9,390	27.8%
Other insurers	2,917	26.1%	10,186	31.8%	12,925	38.2%
Total	$ 11,177	100.00%	$ 32,025	100.00%	$ 33,825	100.00%

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Federated Premium's operations are funded by a revolving loan agreement ("Revolving Agreement") with FlatIron. The Revolving Agreement is structured as a sale of contracts receivable under a sale and assignment agreement with Westchester Premium Acceptance Corporation ("WPAC") (a wholly-owned subsidiary of FlatIron), which gives WPAC the right to sell or assign these contracts receivable. Federated Premium, which services these contracts, has recorded transactions under the Revolving Agreement as secured borrowings. Outstanding borrowings under the Revolving Agreement as of December 31, 2006 and 2005 were approximately $0.01 million and $0.20 million, respectively.

The amounts of WPAC's advances are subject to availability under a borrowing base calculation, with maximum advances outstanding not to exceed the maximum credit commitment. The annual interest rate on advances under the Revolving Agreement equals the prime rate plus additional interest varying from 1.25% to 3.25% based on the prior month's ratio of contracts receivable related to insurance companies with an A.M. Best rating of B or lower, to total contracts receivable. The effective interest rate on this line of credit, based on our average outstanding borrowings under the Revolving Agreement, was 7.82% and 6.39% as of the year ended December 31, 2006 and 2005, respectively.

Finance contracts receivable decreased $5.5 million, or 75.0%, to $1.8 million as of December 31, 2006, as compared to $7.3 million as of December 31, 2005. We anticipate a continued decline in the short-term in connection with premiums financed contracts. The Company anticipates continued use of the direct bill feature associated with the two insurance companies and their automobile lines of business.

The direct billing opportunity is very similar to the premium finance arrangement with respect to down payments and scheduled monthly payments. Direct billing is when the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring payment of the full amount of the policy, either directly from the insured or from a premium finance company. We believe that the direct billing program does not increase our risk because the insurance policy, which serves as collateral, is managed by our computer system. Underwriting criteria are designed with down payment requirements and monthly payments that create policyholder equity, also called unearned premium, in the insurance policy. The equity in the policy is collateral for the extension of credit to the insured. Through our monitoring systems, we track delinquent payments and, in accordance with the terms of the extension of credit, cancel the policy before the policyholder's equity is extinguished. If any excess premium remains after cancellation of the policy and deduction of applicable penalties, this excess is refunded to the policyholder. Similarly, we believe that the premium financing that we offer to our own insureds involves limited credit risk. By primarily financing policies underwritten by our own insurance carriers, our credit risks are reduced because we can more securely rely on the underwriting processes of our own insurance carriers. Furthermore, the direct bill program enables us to closely manage our risk while providing credit to our insureds.

Discontinued Operations

Tax Preparation Services and Ancillary Services

During 2004, we also offered other services at our company-owned and franchised agencies, including tax return preparation and electronic filing and the issuance and renewal of license tags. On January 13, 2005, with an effective date of January 1, 2005, we sold our 80% interest in Express Tax Service, Inc. (Express Tax) (along with its wholly owned subsidiary, EXPRESSTAX Franchise Corporation) to Robert J. Kluba, the president of Express Tax and the holder of the 20% minority interest in Express Tax, and Robert H. Taylor. In exchange for our shares, we received a net cash payment of $311,351, which reflected a purchase price of $660,000 less $348,649 in intercompany receivables we owed to Express Tax. In addition, we received a payment of $1,200,000 in exchange for our agreement not to compete with the current businesses of Express Tax for five years after the sale. The Company's investment in the subsidiary totaled $230,000.

In connection with the transaction, the Company extended the expiration dates for the 75,000 outstanding stock options previously granted to Mr. Kluba and the 30,000 outstanding stock options previously granted to Mr. Kluba's wife. No options remain outstanding under this arrangement at December 31, 2006.

For further information about this transaction, please see Note 24 to our Consolidated Financial Statements included under Item 8 of this Report on Form 10-K.

Franchise Operations

On December 31, 2004, we sold most of the non-current assets related to our franchise operations in Fed USA Retail, Inc. and Fed USA Franchising, Inc. We retained ownership of the current assets and liabilities. For further information about this transaction, please see Note 24 to our Consolidated Financial Statements included under Item 8 of this Report on Form 10-K.

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At the time of sale, we had 42 operating franchises and six pending franchises. The form of franchise agreement in effect during 2004 granted the franchisee a license for the operation of an agency within an exclusive territory for a 10-year period, with two additional 10-year options. We collected from the franchisees a non-refundable initial franchise fee of $14,950, royalty fees, advertising fees, and other fees. Our rights under these franchise agreements were among the assets sold.

In addition, at the time of the sale of our interest in Express Tax, 231 EXPRESSTAX franchises had been granted. The form of EXPRESSTAX franchise agreement in effect during 2004 granted the franchisee a non-exclusive license to open and operate a center for a 10-year period, with two additional 10-year options. As a result of the sale of our interest in Express Tax, we will no longer be entering into such franchise agreements.

MARKETING AND DISTRIBUTION

We are focusing our marketing efforts on continuing to expand our distribution network and market our products and services in other regions of Florida and other states by establishing relationships with additional independent agents and general agents. As this occurs, we will seek to replicate our distribution network in those states. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

Our independent agents and general agents have the authority to sell and bind insurance coverage in accordance with procedures established by Assurance MGA. Assurance MGA reviews all coverage bound by the agents promptly and generally accepts all coverage that falls within stated underwriting criteria. For automobile and commercial general liability policies, Assurance MGA also has the right, within a period of 60 days from a policy's inception, to cancel any policy, upon 45 days' notice, even if the risk falls within our underwriting criteria.

Except for periods under emergency order as defined by the Florida OIR, there typically exists a moratorium on cancellations and non-renewals of various types of insurance coverage, our homeowners' and mobile home policies as underwritten by Assurance MGA provided for the right, within a period of 90 days from a policy's inception, of Assurance MGA to cancel any policy upon 25 days' notice or after 90 days from policy inception with 95 days' notice, even if the risk falls within our underwriting criteria.

We believe that our integrated computer system, which allows for rapid automated premium quotation and policy issuance by our agents, is a key element in providing quality service to both our agents and insureds. For example, upon entering a customer's basic personal information, the customer's driving record is accessed and a premium rate is quoted. If the customer chooses to purchase the insurance, the system can generate the policy on-site.

We believe that the management of our distribution system now centers on our ability to capture and maintain relevant data by producing agent, none of whom are affiliated with us. We believe that information management of agent production, coupled with loss experience, will enable us to maximize profitability.

The following table sets forth the amount and percentages of insurance premiums written through company-owned agencies, franchised agencies and independent agents for the periods indicated:

	Years Ended December 31,					
	2006		2005		2004	
	Premium	Percent	Premium	Percent	Premium	Percent
	(Dollars in Thousands)					

Company-owned agencies	$	-	0.0%	$	-	0.0%	$	11,421	11.4%
Franchised agencies		-	0.0%		-	0.0%		7,999	7.9%
Independent agencies		153,665	100.0%		119,440	100.0%		81,242	80.7%
Total	$	153,665	100.0%	$	119,440	100.0%	$	100,662	100.0%

REINSURANCE

We follow industry practice of reinsuring a portion of our risks and paying for that protection based primarily upon total insured values of all policies in effect and subject to such reinsurance. Reinsurance involves an insurance company transferring or "ceding" all or a portion of its exposure on insurance underwritten by it to another insurer, known as a "reinsurer." The ceding of insurance does not legally discharge the insurer from its primary liability for the full amount of the policies. If the reinsurer fails to meet its obligations under the reinsurance agreement, the ceding company is still required to pay the insured for the loss.

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For the 2006-2007 hurricane season, we have assembled a range of reinsurance products designed to insure the Company for an aggregate of approximately $414.5 million for a minimum of two catastrophic events. The reinsurance treaties contain several complex features and through a series of fluid retentions, attachment points and limitations, additional coverage may be afforded Federated National for events beyond the first two catastrophic events. Our retention will vary depending on the severity and frequency of each catastrophic event. The reinsurance companies and their respective participation in this season's program are noted in the table as follows:

		First Event Participation			Reinstated Premium Protection	
Current AM Best Rating	Reinsurer	$20m in excess of $15m	$40m in excess of $35m	$72m in excess of $75m and FHCF participation	$20m in excess of $15m	$40m in excess of $35m
A+	Ace Tempest Reinsurance Ltd		7.5%	7.5%		
A	Amlin 2001 Syndicate	5.0%	5.0%	5.0%	5.0%	
A-	Amlin Bermuda Ltd	2.5%	4.0%	4.0%	2.5%	
A	American Reinsurance Company			3.5%		
A	Ascot 1414 Syndicate			6.5%		
A++	National Liability and Fire Company		33.8%	6.6%		77.6%
B++	Converium AG		5.0%			
A+	Everest Reinsurance Company		22.0%	4.3%		12.0%
NR	Wentworth Insurance Company Ltd	5.0%		.	5.0%	
A-	Flagstone Reinsurance Ltd		4.3%	4.0%		
A	MAP 2791 Syndicate	2.5%	2.5%	2.5%	2.5%	
A-	New Castle Reinsurance Company Ltd	2.0%	2.0%	2.0%	2.0%	
A	QBE Reinsurance Corporation		1.5%	1.0%		
A	Renaissance Reinsurance, Ltd		12.5%	12.5%		
A+	XL Re Limited			2.5%		
A	Odyssey			3.5%		
A	Catlin Insurance Company Ltd	25.0%			25.0%	
NR	Allianz Risk Transfer (Bermuda) Ltd	33.0%			33.0%	
A	Liberty Mutual Insurance Company			34.7%		
NR4	American Vehicle Insurance Company (Affiliated)	25.0%			25.0%	

In the discussion that follows it should be noted that all amounts of reinsurance are based on management's current analysis of Federated National's exposure levels to catastrophic risk. Our data was subjected to exposure level data analysis at various dates through December 31, 2006. This analysis of our exposure level in relation to the total exposures to the FHCF may produce changes in retentions, limits and reinsurance premiums as a result of increases or decreases in our exposure level.

Our overall reinsurance structure may be divided into four major layers of financial impact in connection with any single catastrophic event. The bottom layer is considered to be the first $15 million of losses. The next layer is considered to be greater than $15 million and less than $35 million. The next layer is considered to be greater than $35 million and less than $233.3 million. The fourth layer is considered to be losses greater than $233.3 million and less than 305.3 million.

For the first and second catastrophic events equal to or less than $15 million, the bottom layer, Federated National will retain 100% of the first $4.3 million and the last $0.7 million of this bottom layer. The FHCF will participate 100% for the $10 million in excess of Federated National's first $4.3 million.

For the first and second catastrophic events with aggregate losses in excess of the first $15.0 million discussed above and less than $35 million, Federated National has acquired 100% reinsurance protection with a single automatic premium reinstatement protection provision. The $20 million of coverage afforded in this layer is by way of 42% traditional, single season, excess of loss ("Traditional") treaties and 58% structured multi-year, excess of loss ("Structured") treaties. As noted in the chart above, American Vehicle will reinsure Federated National via a traditional treaty for 25% of this $20 million layer. Relative to the structured excess of loss reinsurance treaties, terms contained in these treaties afford capacity in this layer beyond the 2006 - 2007 season for two additional hurricane seasons. The structured treaties offer respective coverage for a single event in each of the three hurricane seasons and one additional respective coverage that may be applied as needed in any one of the three hurricane seasons. One of the structured treaties, representing 25% of this layer, contains a provision which prevents the Company from recovery if any single event results in damages that exceed $20 billion in the Unites States and its territories.

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For the first and second catastrophic events where aggregate losses exceed $35 million, but are less than $233.3 million, Federated National has acquired 100% reinsurance protection through a combination of private market reinsurers and the FHCF program. The private market reinsurers have afforded coverage to insure us for $40 million against covered losses in excess of $35 million. The FHCF has afforded coverage to insure us for 90% of loss greater than $55.6 million and less than $231.5 million. The private treaties "wrap around" the FHCF treaty and afford coverage, in aggregate, for losses in excess of $35 million and less than $233.3 million. The FHCF treaty is an aggregate "for the entire season" treaty while the private market treaties afford respective per event coverage. As to reinstatement of coverage for the private market treaties, Federated National has purchased a single automatic premium reinstatement protection provision that would provide for an automatic reinstatement for 89% of the $40 million coverage. Federated National would be responsible for the remaining premium reinstatement protection and the cost in connection with that reinstatement is estimated to be approximately $2.1 million. Federated National would also be responsible for seasonal losses beyond what is afforded through this part of the FHCF coverage.

For an event where aggregate losses exceed $233.3 million, but are less than $305.3 million, Federated National has acquired traditional reinsurance treaties representing 65.3% of this layer without a provision for premium reinstatement protection. Premium reinstatement coverage would be prorated as to amount and if the first event exhausted this coverage then Federated National would be responsible for approximately $10.4 million for reinstatement protection. Additional coverage is afforded to Federated National via Industry Loss Warrants ("ILW"). The ILW policies provide for payments to Federated National based solely on industry wide losses to private and commercial property only in the State of Florida, not-withstanding losses incurred directly by Federated National. A payment to Federated National would only be considered, under the terms of these contracts, if insured wind damages incurred in the State of Florida exceeded amounts varying between $25 billion and $20 billion excluding public property and certain other named exclusions.

The Company is responsible for single catastrophic events with incurred losses in excess of approximately $305 million subject to the terms of the ILW's above.

The estimated cost to the Company in connection with this reinsurance structure is approximately $65 million, which is for the most part payable in quarterly installments that began July 1, 2006 and are being amortized through earned premium in accordance with the provisions and terms contained in the respective treaties.

For the 2005-2006 hurricane season, the excess of loss treaties insured us for approximately $64.0 million, with the Company retaining the first $3.0 million of loss and LAE. The treaties had one full reinstatement provision for each excess layer with 100% additional premium as to time and pro rata as to amount. In addition, we purchased, Reinstatement Premium Protection from the private sector which would reimburse the Company 100% of the cost of reinstatement for the second event. Unused coverage from the first two events carried forward to events beyond the second, in conjunction with a lowered attachment point (as explained below) afforded by the FHCF.

In addition to the excess of loss reinsurance policies (described above), we participated in the FHCF to protect our interest in the insurable risks associated with our homeowner and mobile home owner insurance products. For the first two events, FHCF coverage began after the Company's retention of $3.0 million and its excess of loss reinsures retention of approximately $40.3 million.

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As a result of the loss and LAE incurred in connection with the hurricane activity that occurred in 2004 and 2005, the Company has reflected in its operations the effects of each storm as follows:

2004 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Charley (August 13)	2,571	$ 63.1	$ 53.1	$ 10.0
Frances (September 3)	3,809	53.4	43.3	10.1
Ivan (September 14)	1,062	25.5	-	25.5
Jeanne (September 25)	1,562	13.9	-	13.9
Total Loss Estimate	9,004	$ 155.9	$ 96.4	$ 59.5

2005 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Dennis (July 10)	322	$ 2.7	$ -	$ 2.7
Katrina (August 25)	2,113	14.5	11.5	3.0
Rita (September 20)	19	0.1		0.1
Wilma (October 24)	11,556	164.0	161.0	3.0
Total Loss Estimate	14,010	$ 181.3	$ 172.5	$ 8.8

Effective March 28, 2006, American Vehicle entered into a 100% quota-share reinsurance treaty with Republic. Republic is domiciled in the State of Texas and licensed both directly and on a surplus lines basis in approximately 32 states. Republic has a financial rating of "A-" Excellent with A.M. Best. This arrangement will facilitate the policyholder who requires their commercial general liability insurance policy to come from an insurance company with an A.M. Best rating. Our arrangement with Republic allows for a 4.75% commission on net written premium and reimbursement for all other costs in connection with the treaty such as premium taxes and assessments. We also remit a 1% commission to the intermediary broker on the same net written premium. Under this agreement the Company assumed $22,760 in premiums in connection with its operations in the State of Texas. Our operations in Texas began in December 2006.

We are selective in choosing reinsurers and consider numerous factors, the most important of which are the financial stability of the reinsurer, their history of responding to claims and their overall reputation. In an effort to minimize our exposure to the insolvency of a reinsurer, we evaluate the acceptability and review the financial condition of the reinsurer at least annually.

The Company has ceded its automobile insurance with Transatlantic Reinsurance Company ("Transatlantic"), an A+ rated reinsurance company during various time periods as set forth herein. In 2003 Federated National ceded 40% of its automobile premiums written and losses incurred to Transatlantic. Beginning in November 2001, and continuing through December 31, 2003, American Vehicle reinsured all of its automobile insurance with Transatlantic at various levels. During 2006, 2005 and 2004 American Vehicle did not reinsure any of its automobile insurance products and in 2004 Federated National did not reinsure any of its automobile insurance.

The automobile quota-share reinsurance treaties for 2003 include loss corridors with varying layers of coverage based on ultimate incurred loss ratio results whereby the two insurance companies will retain 100% of the losses between incurred loss ratios of 66% and 86% for policies with an effective date of 2003. Despite the loss corridor, the reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance contracts and it is reasonably possible that the reinsurer may realize a significant loss from the transaction. Our ultimate incurred loss ratios for these treaties as of December 31, 2006 are estimated to be 66.6% and 76.9% for Federated National and American Vehicle, respectively.

During 2005, Federated National entered into a 100% quota-share agreement with its affiliate American Vehicle. The agreement ceded 100% of its premium and losses on all policies with an effective date between July 1, 2005 and December 31, 2005. For presentation purposes, and in accordance with the principles of consolidation, the agreement between the two affiliated insurance companies has been eliminated.

LIABILITY FOR UNPAID LOSSES AND LAE

We are directly liable for loss and LAE payments under the terms of the insurance policies that we write. In many cases there may be a time lag between the occurrence and reporting of an insured loss and our payment of that loss. As required by insurance regulations and accounting rules, we reflect the liability for the ultimate payment of all incurred losses and LAE by establishing a liability for those unpaid losses and LAE for both reported and unreported claims, which represent estimates of future amounts needed to pay claims and related expenses.

When a claim, other than personal automobile, involving a probable loss is reported, we establish a liability for the estimated amount of our ultimate losses and LAE payments. The estimate of the amount of the ultimate loss is based upon such factors as the type of loss, jurisdiction of the occurrence, knowledge of the circumstances surrounding the claim, severity of injury or damage, potential for ultimate exposure, estimate of liability on the part of the insured, past experience with similar claims and the applicable policy provisions.

All newly reported claims received with respect to personal automobile policies are set up with an initial average liability. The average liability for these claims is determined no less than annually by dividing the number of reported claims into the total amount paid during the same period. If a claim is open more than 45 days, that open case liability is evaluated and the liability is adjusted upward or downward according to the facts and circumstances of that particular claim.

In addition, management provides for a liability on an aggregate basis to provide for losses incurred but not reported ("IBNR"). We utilize independent actuaries to help establish liability for unpaid losses and LAE. We do not discount the liability for unpaid losses and LAE for financial statement purposes.

The estimates of the liability for unpaid losses and LAE are subject to the effect of trends in claims severity and frequency and are continually reviewed. As part of this process, we review historical data and consider various factors, including known and anticipated legal developments, changes in social attitudes, inflation and economic conditions. As experience develops and other data become available, these estimates are revised, as required, resulting in increases or decreases to the existing liability for unpaid losses and LAE. Adjustments are reflected in results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates. Among our classes of insurance, the automobile and homeowners' liability claims historically tend to have longer time lapses between the occurrence of the event, the reporting of the claim and the final settlement, than do automobile physical damage and homeowners' property claims. Liability claims often involve parties filing suit and therefore may result in litigation. By comparison, property damage claims tend to be reported in a relatively shorter period of time and settled in a shorter time frame with less occurrence of litigation.

There can be no assurance that our liability for unpaid losses and LAE will be adequate to cover actual losses. If our liability for unpaid losses and LAE proves to be inadequate, we will be required to increase the liability with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of established liability for unpaid losses and LAE could have a material adverse effect on our business, results of operations and financial condition.

The following table sets forth a reconciliation of beginning and ending liability for unpaid losses and LAE as shown in our consolidated financial statements for the periods indicated.

21st Century Holding Company

	Years Ended December 31,		
	2005	2004	2003
	(Dollars in Thousands)		
Balance at January 1:	$ 154,039	$ 46,571	$ 22,656
Less reinsurance recoverables	(128,420)	(9,415)	(7,848)
Net balance at January 1	$ 25,619	$ 37,156	$ 14,808
Incurred related to:			
Current year	$ 35,106	$ 42,242	$ 76,423
Prior years	9,293	6,095	(1,430)
Total incurred	$ 44,399	$ 48,337	$ 74,993
Paid related to:			
Current year	$ 17,420	$ 25,749	$ 42,303
Prior years	25,365	34,125	10,343
Total paid	$ 42,785	$ 59,874	$ 52,646
Net balance at year-end	$ 27,233	$ 25,619	$ 37,156
Plus reinsurance recoverables	12,382	128,420	9,415
Balance at year-end	$ 39,615	$ 154,039	$ 46,571

As shown above, and as a result of our review of liability for losses and LAE, which includes a re-evaluation of the adequacy of reserve levels for prior year's claims, we increased the liability for losses and LAE for claims occurring in prior years by $9.3 million and $6.1 million for the years ended December 31, 2006 and 2005, respectively. We decreased the liability for losses and LAE for claims occurring in prior years by $1.4 million for the year ended December 31, 2004.

During the year ended December 31, 2006, we increased incurred losses and LAE for claims in connection with the hurricanes in 2005 and 2004 by approximately $5.0 million and increased the incurred loss and LAE in connection with our automobile and commercial general liability lines of business by $4.3 million. There can be no assurance concerning future adjustments of reserves, positive or negative, for claims incurred through December 31, 2006.

During the year ended December 31, 2005, we increased incurred losses and LAE for claims in connection with the four hurricanes in 2004 by approximately $10.6 million and decreased the incurred loss and LAE in connection with our automobile and commercial general liability lines of business by $4.5 million. There can be no assurance concerning future adjustments of reserves, positive or negative, for claims incurred through December 31, 2005.

Based upon discussions with our independent actuarial consultants and their statements of opinion on losses and LAE, we believe that the liability for unpaid losses and LAE is currently adequate to cover all claims and related expenses which may arise from incidents reported and IBNR.

21st Century Holding Company

	Years Ended December 31,		
	2005	2004	2003
	(Dollars in Thousands)		
Balance at January 1:	$ 154,039	$ 46,571	$ 22,656
Less reinsurance recoverables	(128,420)	(9,415)	(7,848)
Net balance at January 1	$ 25,619	$ 37,156	$ 14,808
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Current year	$ 17,420	$ 25,749	$ 42,303
Prior years	25,365	34,125	10,343
Total paid	$ 42,785	$ 59,874	$ 52,646
Net balance at year-end	$ 27,233	$ 25,619	$ 37,156
Plus reinsurance recoverables	12,382	128,420	9,415
Balance at year-end	$ 39,615	$ 154,039	$ 46,571

The following table presents total unpaid loss and LAE, net, and total reinsurance recoverable, on a run-off basis, due from our automobile reinsurers as shown in our consolidated financial statements for the periods indicated.

	As of December 31,	
	2006	2005
Transatlantic Reinsurance Company (A+ A.M. Best Rated):		
Unpaid preminums	$ -	$ -
Reinsurance recoverable on paid losses and LAE	113,061	96,283
Unpaid losses and LAE	153,114	732,206
	$ 266,175	$ 828,489
Amounts due from reinsurers consisted of amounts related to:		
Unpaid losses and LAE	$ 153,114	$ 732,206
Reinsurance recoverable on paid losses and LAE	113,061	96,283
Reinsurance receivable	218	453
	$ 266,393	$ 828,942

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In addition to reinsurance due from our automobile reinsurers, we also have reinsurance due to our catastrophic reinsurance companies. These reinsurance payables relate to Hurricane Katrina and Hurricane Wilma from 2005 and to the four hurricanes that occurred in August and September of 2004. The following table presents total unpaid loss and LAE, net, and total reinsurance recoverable due from our catastrophic reinsurers as shown in our consolidated financial statements.

	As of December 31,			
		2006		2005
Catastrophe Excess of Loss (Various participants) and FHCF				
Reinsurance recoverable on paid LAE	$	8,260,720	$	18,820,712
Unpaid losses and LAE		12,229,863		127,685,575
	$	20,490,583	$	146,506,287
Amounts due from reinsurers consisted of amounts related to:				
Unpaid losses and LAE	$	12,229,863	$	127,685,575
Reinsurance recoverable on paid LAE		8,260,720		18,820,712
Reinsurance payable		(24,466,563)		(10,047,585)
	$	(3,975,980)	$	136,458,702

The following table presents the liability for unpaid losses and LAE for the years ended December 31, 1996 through 2006 and does not distinguish between catastrophic and non-catastrophic events. The top line of the table shows the estimated net liabilities for unpaid losses and LAE at the balance sheet date for each of the periods indicated. These figures represent the estimated amount of unpaid losses and LAE for claims arising in all prior years that were unpaid at the balance sheet date, including losses that had been incurred but not yet reported. The portion of the table labeled "Cumulative paid as of" shows the net cumulative payments for losses and LAE made in succeeding years for losses incurred prior to the balance sheet date. The lower portion of the table shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year.

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	Years Ended December 31,									
	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
	(Dollars in Thousands)									
Balance Sheet Liability	$ 27,214	$ 25,621	$ 37,156	$ 14,809	$ 9,136	$ 6,207	$ 6,976	$ 4,428	$ 5,366	$ 4,635
Cumulative paid as of:										
One year later		25,465	35,128	9,969	7,622	5,296	8,228	4,289	3,460	2,694
Two years later			48,299	12,016	9,401	7,222	9,568	5,799	4,499	3,533
Three years later				13,709	9,945	7,711	10,101	6,328	5,111	3,972
Four years later					10,938	7,953	10,352	6,408	5,387	4,241
Five years later						8,171	10,476	6,542	5,227	4,325
Six years later							10,641	6,563	5,216	4,121
Seven years later								6,576	5,220	4,035
Eight years later									5,236	4,034
Nine years later										4,041
Re-estimated net liability as of:										
End of year	$ 27,214	$ 25,621	$ 37,156	$ 14,809	$ 9,136	$ 6,207	$ 6,976	$ 4,428	$ 5,366	$ 4,635
One year later		35,618	44,690	14,256	10,897	6,954	9,445	5,872	4,676	4,360
Two years later			52,317	14,273	10,625	7,842	10,200	6,284	5,157	4,063
Three years later				14,890	10,770	8,069	10,425	6,605	5,352	4,314
Four years later					11,650	8,312	10,616	6,561	5,515	4,386
Five years later						8,542	10,782	6,664	5,384	4,395
Six years later							10,945	6,644	5,396	4,277
Seven years later								6,743	5,400	4,284
									5,361	4,282

Eight years later									
Nine years later									4,045
Cumulative redundancy (deficiency)	$ (9,997)	$ (15,161)	$ (81)	$ (2,514)	$ (2,335)	$ (3,969)	$ (2,315)	$ 5	$ 590
Cumulative redundancy (-) deficiency as a % of reserves originally established	-39.0%	-40.8%	-0.5%	-27.5%	-37.6%	-56.9%	-52.3%	0.1%	12.7%

The cumulative redundancy or deficiency represents the aggregate change in the estimates over all prior years. A deficiency indicates that the latest estimate of the liability for losses and LAE is higher than the liability that was originally estimated and a redundancy indicates that such estimate is lower. It should be emphasized that the table presents a run-off of balance sheet liability for the periods indicated rather than accident or policy loss development for those periods. Therefore, each amount in the table includes the cumulative effects of changes in liability for all prior periods. Conditions and trends that have affected liabilities in the past may not necessarily occur in the future.

As noted above we experienced a $15.2 million cumulative deficiency recognized during the years ended December 31, 2006 and 2005 in connection with the re-estimation of all loss that occurred during the year ended December 31, 2004. and a $10.0 million cumulative deficiency recognized during the year ended December 31, 2006 in connection with the re-estimation of all loss that occurred during the year ended December 31, 2005.

Relative to the $15.2 million deficiency, our homeowner and commercial liability losses totaled $15.4 million and $0.6 million, respectively offset by automobile redundancies totaling $0.9 million. Relative to the $10.0 million deficiency, our homeowner and commercial liability and automobile losses totaled $7.3 million, $1.7 million and $1.0 million, respectively.

As noted last year above we experienced a $7.0 million cumulative deficiency recognized during the year ended December 31, 2005 in connection with the re-estimation of all loss that occurred during the year ended December 31, 2004. When bifurcated between catastrophic losses and non-catastrophic losses, the 2004 cumulative deficiency reflects gross catastrophic losses in connection with the four hurricanes of 2004 totaling $10.6 million netted against a cumulative redundancy in connection with our automobile and commercial general liability lines of business totaling $3.7 million.

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The table below sets forth the differences between loss and LAE reserves as disclosed for Generally Accepted Accounting Principles ("GAAP") basis compared to Statutory Accounting Principles ("SAP") basis of presentation for the years ended 2006 and 2005.

	Years Ended December 31,	
	2006	2005
	(Dollars in Thousands)	
GAAP basis Loss and LAE reserves	$ 39,597	$ 154,039
Less unpaid Losses and LAE ceded	12,383	128,418
Balance Sheet Liability	27,214	25,621
Add Insurance Apportionment Plan	45	112
SAP basis Loss and LAE reserves	$ 27,259	$ 25,733

The table below sets forth the differences between loss and LAE incurred as disclosed for GAAP basis compared to SAP basis presentation for the years ended 2006, 2005 and 2004

	Years Ended December 31,		
	2006	2005	2004
	(Dollars in Thousands)		
GAAP basis Loss and LAE incurred	$ 44,379	$ 48,339	$ 74,993
Intercompany adjusting and other expenses	6,486	7,450	5,597
Insurance apportionment plan	(294)	235	185
SAP basis Loss and LAE incurred	$ 50,571	$ 56,024	$ 80,775

Underwriting results of insurance companies are frequently measured by their Combined Ratios. However, investment income, federal income taxes and other non-underwriting income or expense are not reflected in the Combined Ratio. The profitability of property and casualty insurance companies depends on income from underwriting, investment and service operations. Underwriting results are considered profitable when the Combined Ratio is under 100% and unprofitable when the Combined Ratio is over 100%.

The following table sets forth Loss Ratios, Expense Ratios and Combined Ratios for the periods indicated for the insurance business of Federated National and American Vehicle for 2006, 2005 and 2004. The ratios, inclusive of unallocated loss adjustment expenses ("ULAE"), are shown in the table below, and are computed based upon SAP.

	Years Ended December 31,		
	2006	2005	2004
Loss Ratio	49.7%	67.5%	117.7%
Expense Ratio	44.2%	36.4%	23.1%
Combined Ratio	93.9%	103.9%	140.8%

The main factor for the improved combined ratios from 2006 as compared to 2005 and 2004 can be related to the financial effect from the hurricanes of 2005 and 2004. Other factors for our improved combined loss ratio include, but are not limited to, the termination of unprofitable agency relations, increased scrutiny over fraudulently asserted claims, streamlined paperless claims processing system, new claims management supervision, in-house legal counsel, as well as overall stricter underwriting guidelines.

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The following table reflects the distinction between non-catastrophic and catastrophic losses incurred during the year ended December 31, 2006.

	Calendar year 2006 Non-Catastrophic experience	Catastrophic experience	Total
Net Written Premiums (a)	$ 85,907	$ (762)	$ 85,145
Net Earned Premiums (b)	$ 90,083	$ (762)	$ 89,321
Net Incurred Losses & LAE (c)	$ 39,426	$ 4,974	$ 44,400
Net Underwriting Expense (d)	$ 37,631	$ -	$ 37,631
Loss Ratio (c/b)	43.8%	-652.3%	49.7%
Expense Ratio (d/a)	43.8%	0.0%	44.2%
Combined Ratio	87.6%	-652.3%	93.9%

COMPETITION

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies, many of whom are larger and have greater financial and other resources, have better A.M. Best ratings and offer more diversified insurance coverage. Our competitors include companies which market their products through agents, as well as companies which sell insurance directly to their customers. Large national writers may have certain competitive advantages over agency writers, including increased name recognition, increased loyalty of their customer base and reduced policy acquisition costs. Additionally, during an emergency session in January 2007, the Florida legislature passed and the Governor signed into law a bill known as “CS/HB-1A.” This new law makes fundamental changes to the property and casualty insurance business in Florida and undertakes a multi-pronged approach to address the cost of residential property insurance in Florida. First, the new law requires insurance companies to lower their Florida premium rates for residential property insurance. The new law also authorizes the state-owned insurance company, Citizens, which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance. We may also face competition from new or temporary entrants in our niche markets. In some cases, such entrants may, because of inexperience, desire for new business or other reasons, price their insurance below ours. Although our pricing is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our best interest to compete solely on price. We compete on the basis of underwriting criteria, our distribution network and superior service to our agents and insureds.

In Florida, more than 200 companies are authorized to underwrite homeowners’ insurance. National and regional companies which compete with us in the homeowners’ market include Allstate Insurance Company, State Farm Insurance Company, First Floridian Insurance Company, and Royal Palm Insurance Company. We also compete with several Florida domestic property and casualty companies such as Universal Insurance Company and Coral Insurance Company. During the three months ended June 30, 2006 the Florida OIR announced the take over of three of our major competitors due to the poor financial condition stemming from the effects of last year’s catastrophic hurricanes. We have experienced an increase in policy volume relative to our homeowners’ insurance products due to the narrowed competition.

Comparable companies which compete with us in the commercial general liability insurance market include Century Surety Insurance Company, Atlantic Casualty Insurance Company, Colony Insurance Company and Burlington/First

Financial Insurance Companies.

With respect to automobile insurance in Florida, we compete with more than 100 companies, which underwrite personal automobile insurance. Comparable companies which compete with us in the personal automobile insurance market include Affirmative Insurance Holdings, Inc., which acquired our non-standard automobile agency business in Florida in December 2004, U.S. Security Insurance Company, United Automobile Insurance Company, Direct General Insurance Company and Security National Insurance Company, as well as major insurers such as Progressive Casualty Insurance Company.

Competition could have a material adverse effect on our business, results of operations and financial condition.

REGULATION

General

We are or will be subject to the laws and regulations in Florida, Georgia, Alabama, Kentucky, Louisiana, South Carolina, Virginia, Missouri, Arkansas and Texas, and regulations of any other states in which we seek to conduct business in the future. The regulations cover all aspects of our business and are generally designed to protect the interests of insurance policyholders, as opposed to the interests of shareholders. Such regulations relate to authorized lines of business, capital and surplus requirements, allowable rates and forms, investment parameters, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, market conduct, maximum amount allowable for premium financing service charges and a variety of other financial and non-financial components of our business. Our failure to comply with certain provisions of applicable insurance laws and regulations could have a material adverse effect on our business, results of operations or financial condition. In addition, any changes in such laws and regulations, including the adoption of consumer initiatives regarding rates charged for coverage, could materially and adversely affect our operations or our ability to expand. A recent example of such consumer initiatives may be found with Florida’s property insurers’ operating under a new emergency rule which require existing premium rates as of January 25, 2007, to remain in effect until a rate filing reflecting the provisions as provided in Florida’s newly enacted property insurance legislation. The legislation, which among other issues, reduces anticipated reinsurance costs and expands the role of Citizens. Other provisions contained in the emergency rule prevent non-renewals and cancellation (except for material misrepresentation and non-payment of premium) until the new rate filing is made and new restrictions on coverage are prohibited. We are unaware of any other consumer initiatives which could have a material adverse effect on our business, results of operations or financial condition.

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Many states have also enacted laws which restrict an insurer's underwriting discretion, such as the ability to terminate policies, terminate agents or reject insurance coverage applications, and many state regulators have the power to reduce, or to disallow increases, in premium rates. These laws may adversely affect the ability of an insurer to earn a profit on its underwriting operations.

Most states have insurance laws requiring that rate schedules and other information be filed with the state's insurance regulatory authority, either directly or through a rating organization with which the insurer is affiliated. The regulatory authority may disapprove a rate filing if it finds that the rates are inadequate, excessive or unfairly discriminatory. Rates, which are not necessarily uniform for all insurers, vary by class of business, hazard covered, and size of risk. Certain states have recently adopted laws or are considering proposed legislation which, among other things, limit the ability of insurance companies to effect rate increases or to cancel, reduce or non-renew insurance coverage with respect to existing policies, particularly personal automobile insurance. As discussed above, the recent consumer initiatives with Florida's property insurers' demonstrate the state's ability to adopt such laws. Also, the Florida legislature may adopt additional laws of this type in the future, which may adversely affect the Company's business.

Most states require licensure or regulatory approval prior to the marketing of new insurance products. Typically, licensure review is comprehensive and includes a review of a company's business plan, solvency, reinsurance, character of its officers and directors, rates, forms and other financial and non-financial aspects of a company. The regulatory authorities may not allow entry into a new market by not granting a license or by withholding approval.

All insurance companies must file quarterly and annual statements with certain regulatory agencies and are subject to regular and special examinations by those agencies. In accordance with the National Association of Insurance Commissioners ("NAIC") the Florida OIR intends to comply with recent initiatives recommending that all insurance companies under the same insurance holding company registration statement, be subjected to concurrent triennial examinations. Accordingly, both Federated National and American Vehicle were scheduled for a triennial examination during 2006. The last regulatory examination conducted by the OIR on Federated National covered the three-year period ended on December 31, 2004.

While Federated National and American Vehicle were scheduled to have their statutorily required triennial examination during 2006, the OIR limited its examination to American Vehicle. American Vehicle's examination was for the three years ended December 31, 2005. A loss reserve deficiency totaling approximately $1.3 million (net of income taxes) was recorded in the fourth quarter of 2006 in connection with the OIR examination.

Federated National's 2004 regularly scheduled statutory triennial examination during 2005 for the three years ended December 31, 2004 as performed by the Florida OIR resulted in no corrective orders being issued. We may be the subject of additional targeted examinations or analysis. These examinations or analysis may result in one or more corrective orders being issued by the Florida OIR.

In some instances, various states routinely require deposits of assets for the protection of policyholders either in those states or for all policyholders. As an example, the Florida OIR requires Federated National and American Vehicle to have securities with a fair value of $1.0 million. As of December 31, 2006, Federated National and American Vehicle held investment securities with a fair value of approximately $985,630, each as deposits with the State of Florida. Additionally, as of December 31, 2006 American Vehicle has a cash deposit totaling $109, 509 with the State of Louisiana and on investment security with a fair value totaling $388,040 with the State of Alabama. Subsequent to year end, each insurance company contributed an additional $30,000 of investment securities with the State of Florida to cure their respective $14,370 shortfall.

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Restrictions in Payments of Dividends by Domestic Insurance Companies

Under Florida law, a domestic insurer may not pay any dividend or distribute cash or other property to its shareholders except out of that part of its available and accumulated capital surplus funds which is derived from realized net operating profits on its business and net realized capital gains. A Florida domestic insurer may not make dividend payments or distributions to shareholders without prior approval of the Florida OIR if the dividend or distribution would exceed the larger of (i) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two-year carryforward, (ii) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains or (iii) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three-year carryforward with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains. Alternatively, a Florida domestic insurer may pay a dividend or distribution without the prior written approval of the Florida OIR (i) if the dividend is equal to or less than the greater of (a) 10.0% of the insurer's capital surplus as regards policyholders derived from realized net operating profits on its business and net realized capital gains or (b) the insurer's entire net operating profits and realized net capital gains derived during the immediately preceding calendar year, (ii) the insurer will have policy holder capital surplus equal to or exceeding 115.0% of the minimum required statutory capital surplus after the dividend or distribution, (iii) the insurer files a notice of the dividend or distribution with the Florida OIR at least ten business days prior to the dividend payment or distribution and (iv) the notice includes a certification by an officer of the insurer attesting that, after the payment of the dividend or distribution, the insurer will have at least 115% of required statutory capital surplus as to policyholders. Except as provided above, a Florida domiciled insurer may only pay a dividend or make a distribution (i) subject to prior approval by the Florida OIR or (ii) 30 days after the Florida OIR has received notice of such dividend or distribution and has not disapproved it within such time.

Under these laws, based on their respective 2006 surplus and income, Federated National and American Vehicle would not be permitted to pay dividends in 2006. No dividends were paid by Federated National or American Vehicle in 2005, 2004 or 2003, and none are anticipated in 2007. Although we believe that amounts required to meet our financial and operating obligations will be available from sources other than dividends from our insurance subsidiaries, there can be no assurance in this regard. Further, there can be no assurance that, if requested, the Florida OIR will allow any dividends in excess of the amount available, to be paid by Federated National and American Vehicle to us in the future. The maximum dividends permitted by state law are not necessarily indicative of an insurer's actual ability to pay dividends or other distributions to a parent company, which also may be constrained by business and regulatory considerations, such as the impact of dividends on capital surplus, which could affect an insurer's competitive position, the amount of premiums that can be written and the ability to pay future dividends. Further, state insurance laws and regulations require that the statutory capital surplus of an insurance company following any dividend or distribution by it be reasonable in relation to its outstanding liabilities and adequate for its financial needs.

While the non-insurance company subsidiaries (Assurance MGA, Superior and any other affiliate) are not subject directly to the dividend and other distribution limitations, insurance holding company regulations govern the amount that any affiliate within the holding company system may charge any of the insurance companies for service (e.g., management fees and commissions).

NAIC Risk Based Capital Requirements

In order to enhance the regulation of insurer solvency, the NAIC established risk-based capital requirements for insurance companies that are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policy holders. These requirements measure three major areas of risk facing property and casualty insurers: (i) underwriting risks, which encompass the risk of adverse loss developments and inadequate pricing; (ii)

declines in asset values arising from credit risk; and (iii) other business risks from investments. Insurers having less statutory surplus than required will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. The Florida OIR, which follows these requirements, could require Federated National or American Vehicle to cease operations in the event they fail to maintain the required statutory capital.

Based upon the 2006 statutory financial statements for American Vehicle, statutory surplus exceeded all regulatory action levels established by the NAIC's risk-based capital requirements. Based upon the 2006 statutory financial statements for Federated National, statutory surplus did not exceed company action levels established by the NAIC. Federated National's results require us to submit a plan containing corrective actions. Federated has not submitted its plan for corrective action yet, however we will submit a plan during the second quarter of 2007. We do not anticipate significant regulatory action in connection with Federated National's 2006 Risk Based Capital ("RBC") results.

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Based on Risk Based Capital requirements, the extent of regulatory intervention and action increases as the ratio of an insurer's statutory surplus to its Authorized Control Level ("ACL"), as calculated under the NAIC's requirements, decreases. The first action level, the Company Action Level, requires an insurer to submit a plan of corrective actions to the insurance regulators if statutory surplus falls below 200.0% of the ACL amount. The second action level, the Regulatory Action Level, requires an insurer to submit a plan containing corrective actions and permits the insurance regulators to perform an examination or other analysis and issue a corrective order if statutory surplus falls below 150.0% of the ACL amount. The third action level, ACL, allows the regulators to rehabilitate or liquidate an insurer in addition to the aforementioned actions if statutory surplus falls below the ACL amount. The fourth action level is the Mandatory Control Level, which requires the regulators to rehabilitate or liquidate the insurer if statutory surplus falls below 70.0% of the ACL amount. Federated National's ratio of statutory surplus to its ACL was 165.4 %, 154.0% and 125.5% at December 31, 2006, 2005 and 2004, respectively. American Vehicle's ratio of statutory surplus to its ACL was 444.2%, 329.7% and 545.1% at December 31, 2006, 2005 and 2004, respectively.

NAIC Insurance Regulatory Information Systems Ratios

The NAIC has also developed Insurance Regulatory Information Systems ("IRIS") ratios to assist state insurance departments in identifying companies which may be developing performance or solvency problems, as signaled by significant changes in the companies' operations. Such changes may not necessarily result from any problems with an insurance company, but may merely indicate changes in certain ratios outside the ranges defined as normal by the NAIC. When an insurance company has four or more ratios falling outside "usual ranges," state regulators may investigate to determine the reasons for the variance and whether corrective action is warranted.

As of December 31, 2006, Federated National was outside NAIC's usual ranges with respect to its IRIS tests on six out of thirteen ratios. There was one exception in connection with surplus growth, one exception in connection with liabilities to liquid assets and four exceptions in connection with adverse homeowner claims in connection with the 2004 hurricanes.

As of December 31, 2005, Federated National was outside NAIC's usual ranges with respect to its IRIS tests on six out of thirteen ratios. With the exception of one of these test results, all of test results can be attributed to the significant degradation of policyholders' surplus stemming from the losses incurred in its homeowners' line of business as a result of the five hurricanes in 2005 and the four hurricanes in 2004. Although there was only modest improvement with respect to our 2005 IRIS test results as compared to 2004 results, management's attention to risk retention techniques in connection with the five Florida hurricanes during 2005 was the major reason for improvement in an otherwise adverse year for property insurers.

As of December 31, 2006, American Vehicle was outside NAIC's usual range for one of thirteen ratios. The exception was in connection with the net increase in adjusted policyholders' surplus. During 2006, net income and a decrease in non admitted securities were the major contributors to the 2006 change to policyholder surplus.

As of December 31, 2005, American Vehicle was outside NAIC's usual ranges for two out of thirteen ratios. The first ratio relates to a larger than anticipated change in net writings, the second ratio relates to a modestly higher ratio of Gross Agents' Balances due to the Company over the Policyholder Surplus. These Gross Agent Balances are all less than ninety days old.

We do not currently believe that the Florida OIR will take any significant action with respect to Federated National or American Vehicle regarding the IRIS ratios, although there can be no assurance that will be the case.

Insurance Holding Company Regulation

We are subject to laws governing insurance holding companies in Florida where Federated National and American Vehicle are domiciled. These laws, among other things, (i) require us to file periodic information with the Florida OIR, including information concerning our capital structure, ownership, financial condition and general business operations, (ii) regulate certain transactions between us and our affiliates, including the amount of dividends and other distributions and the terms of surplus notes and (iii) restrict the ability of any one person to acquire certain levels of our voting securities without prior regulatory approval. Any purchaser of 5% or more of the outstanding shares of our Common Stock will be presumed to have acquired control of Federated National and American Vehicle unless the Florida OIR, upon application, determines otherwise.

Finance Company Regulation

Our financing program is also subject to certain laws governing the operation of premium finance companies. These laws pertain to such matters as books and records that must be kept, forms, licensing, fees and charges. For example, in Florida, the maximum late payment fee Federated Premium may charge is the greater of $10 per month or 5% of the amount of the overdue payment.

Underwriting and Marketing Restrictions

During the past several years, various regulatory and legislative bodies have adopted or proposed new laws or regulations to address the cyclical nature of the insurance industry, catastrophic events and insurance capacity and pricing. These regulations include (i) the creation of "market assistance plans" under which insurers are induced to provide certain coverages, (ii) restrictions on the ability of insurers to rescind or otherwise cancel certain policies in mid-term, (iii) advance notice requirements or limitations imposed for certain policy non-renewals and (iv) limitations upon or decreases in rates permitted to be charged.

Legislation

From time to time, new regulations and legislation are proposed to limit damage awards, to control plaintiffs' counsel fees, to bring the industry under regulation by the Federal government, to control premiums, policy terminations and other policy terms and to impose new taxes and assessments. It is not possible to predict whether, in what form or in what jurisdictions, any of these proposals might be adopted, or the effect, if any, on us.

Industry Ratings Services

In August 2004, A.M. Best Company notified us that Federated National and American Vehicle were being placed under review with negative implications. In connection with this review, we requested that A.M. Best cease its ratings of these subsidiaries and assign a rating of “NR-4 - Not rated, company’s request” to each. The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, obtaining adequate reinsurance or borrowing on our line of credit. Federated National and American Vehicle are currently rated "A" ("Unsurpassed," which is first of six ratings) by Demotech, Inc. A.M. Best’s and Demotech’s ratings are based upon factors of concern to agents, reinsurers and policyholders and are not primarily directed toward the protection of investors.

EMPLOYEES

As of December 31, 2006, we had approximately 122 employees, including two executive officers. We are not a party to any collective bargaining agreement and we have not experienced work stoppages or strikes as a result of labor disputes. We consider relations with our employees to be satisfactory.

SENIOR MANAGEMENT

Set forth below is certain information concerning our executive officers who are not also directors:

James Gordon Jennings, III was appointed Chief Financial Officer of 21st Century in August 2002. Mr. Jennings became our Controller in May 2000 and for approximately 10 years prior thereto was employed by American Vehicle, where he was involved with all aspects of property and casualty insurance. Mr. Jennings’, formerly a certified public accountant, also holds a Certificate in General Insurance and an Associate in Insurance Services as designated by the Insurance Institute of America.

Kent M. Linder assumed the position of Chief Operating Officer of 21st Century in September 2003 and was designated an executive officer by our Board of Directors in March 2005. Prior to this position, Mr. Linder served 21st Century as Director of Franchise Development from January 2001 to July 2003 and previous to that as the President of Federated Agency Group from December 1998 to January 2001. Prior to joining our management team, Mr. Linder owned and operated a group of 18 insurance agencies in the Orlando, Florida area. Mr. Linder acquired his management experience while spending 12 years with United Parcel Service, in which he served in various

management positions. Mr. Linder holds a bachelor's degree from the University of South Florida in Finance and is a licensed 220 property and casualty agent and 215 life agent. Mr. Linder resigned his position as Chief Operating Officer effective January 31, 2006 subject to a separation agreement executed and filed with the Securities and Exchange Commission. There were no disagreements in connection with Mr. Linder's separation.

ITEM 1A RISK FACTORS

We are subject to certain risks in our business operations which are described below. Careful consideration of these risks should be made before making an investment decision. The risks and uncertainties described below are not the only ones facing 21st Century. Additional risks and uncertainties not presently known or currently deemed immaterial may also impair our business operations.

Risks Related to Our Business

The State of Florida, where our headquarters and a substantial portion of our policies are written, has experienced nine hurricanes from August 2004 through October 2005 and it has affected our financial results.

We write insurance policies that cover homeowners', business owners and automobile owners for losses that result from, among other things, catastrophes. Catastrophic losses can be caused by hurricanes, tropical storms, tornadoes, wind, hail, fires, riots and explosions, and their incidence and severity are inherently unpredictable. The extent of losses from a catastrophe is a function of two factors: the total amount of the insurance company's exposure in the area affected by the event and the severity of the event. Our policyholders are currently concentrated in South and Central Florida, which is especially subject to adverse weather conditions such as hurricanes and tropical storms.

During the years ended December 31, 2004 and 2005, the State of Florida experienced nine hurricanes. One of our subsidiaries, Federated National, incurred significant losses relative to its homeowners' and mobile homeowners' insurance lines of business in connection with these catastrophic weather events. The table below illustrates the magnitude of each storm both gross and net of our reinsurance arrangements.

Hurricane	Estimated Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in Millions)		
Charley (August 13, 2004)	2,571	$ 63	$ 53	$ 10
Frances (September 3, 2004)	3,809	53	43	10
Ivan (September 14, 2004)	1,062	25	-	25
Jeanne (September 25, 2004)	1,562	14	-	14
Arlene (June 7, 2005)	-	-	-	-
Dennis (July 10, 2005)	322	3	-	3
Katrina (August 25, 2005)	2,113	14	11	3
Rita (September 20, 2005)	19	-	-	-
Wilma (October 24, 2005)	11,556	164	161	3
Total Loss Estimate	23,014	$ 336	$ 268	$ 68

Please refer to the preceding section titled REINSURANCE for a detailed discussion regarding our reinsurance treaties.

Although we follow the industry practice of reinsuring a portion of our risks, our costs of obtaining reinsurance have increased and we may not be able to successfully alleviate risk through reinsurance arrangements.

We have a reinsurance structure that is a combination of private reinsurance and the FHCF. Our reinsurance structure is comprised of several reinsurance companies with varying levels of participation providing coverage for loss and LAE at pre-established minimum and maximum amounts. Losses incurred in connection with a catastrophic event below the minimum and above the maximum are the responsibility of Federated National.

As a result of the nine hurricanes experienced in Florida during the fourteen month period between August 2004 and October 2005, we continue to review, and may determine to modify, our reinsurance structure.

Although the occurrence of hurricanes hitting Florida has increased during recent years, some weather analysts believe that we have entered a period of greater hurricane activity while others suggest a diminished expectation for the near future. To address this risk, we are exploring alternatives to reduce our exposure to these types of storms. Although these measures may increase operating expenses, management believes that they will assist us in protecting long-term profitability, although there can be no assurances that will be the case.

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The insolvency of our primary reinsurer or any of our other current or future reinsurers, or their inability otherwise to pay claims, would increase the claims that we must pay, thereby significantly harming our results of operations. In addition, prevailing market conditions have limited the availability and increased the cost of reinsurance, which may have the effect of increased costs and reduced profitability.

We may experience financial exposure from climate change.

Our financial exposure from climate change is most notably associated with losses in connection with the occurrence of hurricanes striking Florida. We mitigate the risk of financial exposure from climate change by restrictive underwriting criteria, sensitivity to geographic concentrations and reinsurance.

Restrictive underwriting criteria can include, but are not limited to, higher premiums and deductibles and more specifically excluded policy risks such as fences and screened-in enclosures. New technological advances in computer generated geographical mapping afford us an enhanced perspective as to geographic concentrations of policyholders and proximity to flood prone areas. Our amount of maximum reinsurance coverage is determined by subjecting our homeowner and mobile homeowner exposures to statistical forecasting models that are designed to quantify a catastrophic event in terms of the frequency of a storm occurring once in every “n” years. Our reinsurance coverage contemplated a catastrophic event occurring once every 100 years. Our amount of losses retained (our deductible) in connection with a catastrophic event is determined by market capacity, pricing conditions and surplus preservation.

Our loss reserves may be inadequate to cover our actual liability for losses, causing our results of operations to be adversely affected.

We maintain reserves to cover our estimated ultimate liabilities for loss and LAE. These reserves are estimates based on historical data and statistical projections of what we believe the settlement and administration of claims will cost based on facts and circumstances then known to us. Actual loss and LAE reserves, however, may vary significantly from our estimates.

Factors that affect unpaid loss and LAE include the estimates made on a claim-by-claim basis known as “case reserves” coupled with bulk estimates known as “incurred by not reported.” Periodic estimates by management of the ultimate costs required to settle all claim files are based on our analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

Because of the uncertainties that surround estimated loss reserves, we cannot be certain that our reserves will be adequate to cover our actual losses. If our reserves for unpaid losses and LAE are less than actual losses and LAE, we will be required to increase our reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of our reserves for unpaid losses and LAE could substantially harm our results of operations and financial condition.

We face risks in connection with potential material weakness resulting from our Sarbanes-Oxley Section 404 management report and any related remedial measures that we undertake.

In conjunction with (i) our ongoing reporting obligations as a public company and (ii) the requirements of Section 404 of the Sarbanes-Oxley Act that management report as of December 31, 2006 on the effectiveness of our internal control over financial reporting and identify any material weaknesses in our internal control over financial reporting, we engaged in a process to document, evaluate and test our internal controls and procedures, including corrections to existing controls and additional controls and procedures that we may implement. As a result of this evaluation and testing process, our management identified a number of significant deficiencies, consequently we have implemented and will continue to implement additional controls and procedures, including modifying many of our controls and financial reporting processes, and standardizing our IT policies and procedures. These efforts could result in increased cost and could divert management attention away from operating our business. As a result of the identified significant deficiencies, even though our management believes that the efforts to remediate and re-test our internal control deficiencies have resulted in the improved operation of our internal control over financial reporting, we cannot be certain that the measures we have taken or those contemplated will sufficiently and satisfactorily remediate the identified significant deficiencies in full.

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In future periods, if the process required by Section 404 of the Sarbanes-Oxley Act reveals further significant deficiencies or material weaknesses, the correction of any such significant deficiencies or material weaknesses could require additional remedial measures that could be costly and time-consuming. In addition, the discovery of material weaknesses could also require the restatement of prior period operating results. If a material weakness exists as of a future period year-end (including a material weakness identified prior to year-end for which there is an insufficient period of time to evaluate and confirm the effectiveness of the corrections or related new procedures), our management will be unable to report favorably as of such future period year-end as to the effectiveness of our control over financial reporting we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price and potentially subject us to litigation.

The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or our results of operations.

Various provisions of our policies, such as limitations or exclusions from coverage which have been negotiated to limit our risks, may not be enforceable in the manner we intend. At the present time we employ a variety of endorsements to our policies that limit exposure to known risks, including but not limited to exclusions relating to types of vehicles we insure, specific artisan activities and homes in close proximity to the coast line.

In addition, the policies we issue contain conditions requiring the prompt reporting of claims to us and our right to decline coverage in the event of a violation of that condition. While our insurance product exclusions and limitations reduce the loss exposure to us and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or legislation could be enacted modifying or barring the use of such endorsements and limitations in a way that would adversely effect our loss experience, which could have a material adverse effect on our financial condition or results of operations.

The effects of emerging claim and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social and other conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued insurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a contract is issued.

Our failure to pay claims accurately could adversely affect our business, financial results and capital requirements.

We must accurately evaluate and pay claims that are made under our policies. Many factors affect our ability to pay claims accurately, including the training and experience of our claims representatives, the culture of our claims organization and the effectiveness of our management, our ability to develop or select and implement appropriate procedures and systems to support our claims functions and other factors. Our failure to pay claims accurately could lead to material litigation, undermine our reputation in the marketplace, impair our image and negatively affect our financial results.

In addition, if we do not train new claims adjusting employees effectively or if we lose a significant number of experienced claims adjusting employees, our claims department’s ability to handle an increasing workload as we grow could be adversely affected. In addition to potentially requiring that growth be slowed in the affected markets, we could suffer decreased quality of claims work, which in turn could lower our operating margins.

If we are unable to continue our growth because our capital must be used to pay greater than anticipated claims, our financial results may suffer.

We have grown rapidly over the last few years. Our future growth will depend on our ability to expand the types of insurance products we offer and the geographic markets in which we do business both balanced by the business risks we chose to assume and cede. We believe that our Company is sufficiently capitalized to operate our business as it now exists and as we currently plan to expand it. Our existing sources of funds include possible sales of our investment securities, our revolving loan from Flatiron and our earnings from operations and investments. Unexpected catastrophic events in our market areas, such as the hurricanes experienced in Florida, have resulted and may result in greater claims losses than anticipated, which could require us to limit or halt our growth while we redeploy our capital to pay these unanticipated claims unless we are able to raise additional capital or increase our earnings in our other divisions.

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We may require additional capital in the future which may not be available or only available on unfavorable terms.

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. To the extent that our present capital is insufficient to meet future operating requirements and/or cover losses, we may need to raise additional funds through financings or curtail our growth. Based on our current operating plan, we believe current capital together with our anticipated retained earnings will support our operations without the need to raise additional capital. However, we cannot provide any assurance in that regard, since many factors will affect our capital needs and their amount and timing, including our growth and profitability, our claims experience, and the availability of reinsurance, as well as possible acquisition opportunities, market disruptions and other unforeseeable developments. If we had to raise additional capital, equity or debt financing may not be available at all or may be available only on terms that are not favorable to us. In the case of equity financings, dilution to our stockholders could result, and in any case such securities may have rights, preferences and privileges that are senior to those of existing shareholders. If we cannot obtain adequate capital on favorable terms or at all, our business, financial condition or results of operations could be materially adversely affected.

Our business is heavily regulated, and changes in regulation may reduce our profitability and limit our growth.

We are subject to extensive regulation in the states in which we conduct business. This regulation is generally designed to protect the interests of policyholders, as opposed to shareholders and other investors, and relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, premium rates and a variety of other financial and non-financial components of an insurance company’s business. The NAIC and state insurance regulators are constantly reexamining existing laws and regulations, generally focusing on modifications to holding company regulations, interpretations of existing laws and the development of new laws.

From time to time, some states in which we conduct business have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. In other situations, states in which we conduct business have considered or enacted laws that impact the competitive environment and marketplace for property and casualty insurance. For example, Florida recently enacted legislation that requires us to charge rates for homeowners insurance that we believe are inadequate to cover the related underwriting risk. This same legislation authorizes a state-owned insurance company to reduce its premium rates and begin competing against private insurers in the Florida residential property insurance market.

Currently the federal government does not directly regulate the insurance business. However, in recent years the state insurance regulatory framework has come under increased federal scrutiny. Congress and some federal agencies from time to time investigate the current condition of insurance regulation in the United States to determine whether to impose federal regulation or to allow an optional federal charter, similar to banks. In addition, changes in federal legislation and administrative policies in several areas, including changes in the Gramm-Leach-Bliley Act, financial services regulation and federal taxation, can significantly impact the insurance industry and us.

We cannot predict with certainty the effect any enacted, proposed or future state or federal legislation or NAIC initiatives may have on the conduct of our business. Furthermore, there can be no assurance that the regulatory requirements applicable to our business will not become more stringent in the future or result in materially higher costs than current requirements. Changes in the regulation of our business may reduce our profitability, limit our growth or otherwise adversely affect our operations.

Our insurance companies are subject to minimum capital and surplus requirements, and our failure to meet these requirements could subject us to regulatory action.

Our insurance companies are subject to risk-based capital standards and other minimum capital and surplus requirements imposed under applicable state laws, including the laws of their state of domicile, Florida. The risk-based capital standards, based upon the Risk-Based Capital Model Act adopted by the NAIC require our insurance companies to report their results of risk-based capital calculations to state departments of insurance and the NAIC. These risk-based capital standards provide for different levels of regulatory attention depending upon the ratio of an insurance company's total adjusted capital, as calculated in accordance with NAIC guidelines, to its authorized control level risk-based capital. Authorized control level risk-based capital is the number determined by applying the NAIC's risk-based capital formula, which measures the minimum amount of capital that an insurance company needs to support its overall business operations.

Any failure by one of our insurance companies to meet the applicable risk-based capital or minimum statutory capital requirements imposed by the laws of Florida or other states where we do business could subject it to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, state supervision or liquidation. As noted previously in the section titled "REGULATION" under "NAIC Risk Based Capital Requirements", Federated National, statutory surplus did not exceed company action levels established by the NAIC primarily due the negative effect on operations as a result of the occurrence of the nine hurricanes during the fourteen months between August 2004 and October 2005. Federated National's 2005 results required us to submit a plan to the State of Florida documenting our plan for financial improvement. Our plan, as submitted, centered on a significantly stronger reinsurance structure and improved claims management. The State of Florida did not object to our plan. Federated National's 2006 results will require us to submit an updated plan during 2007 to the State of Florida documenting our plan for continued financial improvement.

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Any changes in existing risk-based capital requirements or minimum statutory capital requirements may require us to increase our statutory capital levels, which we may be unable to do.

Our revenues and operating performance may fluctuate with business cycles in the property and casualty insurance industry.

Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns characterized by periods of significant competition in pricing and underwriting terms and conditions, which is known as a "soft" insurance market, followed by periods of lessened competition and increasing premium rates, which is known as a "hard" insurance market. Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern, with profitability generally increasing in hard markets and decreasing in soft markets. At present, we are experiencing a soft market in our automobile and commercial general liability sectors while a hard market persists in our property sector. We cannot predict, however, how long these market conditions will persist. We do not compete entirely on price or targeted market share. Our ability to compete is governed by our ability to assess and price an insurance product with an acceptable risk for obtaining profit.

Our revenues and operating performance will fluctuate due to statutorily approved assessments that support property and casualty insurance pools and associations.

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, the Florida Joint Underwriters Association, the Florida Insurance Guarantee Association, Citizens Property Insurance Company and the Florida Hurricane Catastrophic Fund. The reason for the current assessments is based on the catastrophic effects to the property and casualty insurance industry in the State of Florida from the hurricanes that occurred during the fourteen months between August 2004 and October 2005.

Primarily, all of the assessments result in a charge to current operations. The insurance companies will then pass the assessments on to insurance policies which are not yet in force and reflect the collection of these assessments as fully earned credits to operations in the period collected.

Future assessments are undeterminable at this time.

We may not obtain the necessary regulatory approvals to expand the types of insurance products we offer or the states in which we operate.

We currently have an application pending in California to underwrite and sell commercial general liability insurance. The insurance regulators in this state may request additional information, add conditions to the license that we find unacceptable, or deny our application. This would delay or prevent us from operating in that state. If we want to operate in any additional states, we must file similar applications for licenses, which we may not be successful in obtaining.

We requested that A.M. Best cease rating our insurance subsidiaries. As a result, we may be unable to write or renew desirable insurance policies or obtain adequate reinsurance, which would limit or halt our growth and harm our business.

Third-party rating agencies assess and rate the ability of insurers to pay their claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer's profitability, debt and cash levels, customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves, and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

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In August 2004, A.M. Best Company notified us that Federated National and American Vehicle were being placed under review with negative implications. In 2003 A.M. Best had assigned Federated National a B rating ("Fair," which is the seventh of 14 rating categories) and American Vehicle a B+ rating ("Very Good," which is the sixth of 14 rating categories). In connection with this review, we requested that A.M. Best cease its ratings of these subsidiaries. A rating of “NR-4 Not rated, company’s request” resulted. The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from obtaining adequate reinsurance, or from borrowing on our line of credit.

We rely on independent agents to write our insurance policies, and if we are not able to attract and retain independent agents, our revenues would be negatively affected.

We currently market and distribute Federated National's, American Vehicle's and third-party insurers' products and our other services through contractual relationships with a network of approximately 1,500 independent agents and a selected number of general agents. Our independent agents are our primary source for our automobile and property insurance policies. Many of our competitors also rely on independent agents. As a result, we must compete with other insurers for independent agents' business. Our competitors may offer a greater variety of insurance products, lower premiums for insurance coverage, or higher commissions to their agents. If our products, pricing and commissions do not remain competitive, we may find it more difficult to attract business from independent agents to sell our products. A material reduction in the amount of our products that independent agents sell would negatively affect our revenues.

We rely on our information technology and telecommunications systems, and the failure of these systems could disrupt our operations.

Our business is highly dependent upon the successful and uninterrupted functioning of our current information technology and telecommunications systems. We rely on these systems to process new and renewal business, provide customer service, make claims payments and facilitate collections and cancellations, as well as to perform actuarial and other analytical functions necessary for pricing and product development. As a result, the failure of these systems could interrupt our operations and adversely affect our financial results.

Nonstandard automobile insurance historically has a higher frequency of claims than standard automobile insurance, thereby increasing our potential for loss exposure beyond what we would be likely to experience if we offered only standard automobile insurance.

Nonstandard automobile insurance is provided to insureds that are unable to obtain preferred or standard insurance coverage because of their payment histories, driving records, age, vehicle types, or prior claims histories. This type of automobile insurance historically has a higher frequency of claims than does preferred or standard automobile insurance policies, although the average dollar amount of the claims is usually smaller under nonstandard insurance policies. As a result, we are exposed to the possibility of increased loss exposure and higher claims experience than would be the case if we offered only standard automobile insurance.

Florida's personal injury protection insurance statute contains provisions that favor claimants, causing us to experience a higher frequency of claims than might otherwise be the case if we operated only outside of Florida.

Florida's personal injury protection insurance statute limits an insurer's ability to deny benefits for medical treatment that is unrelated to the accident, that is unnecessary, or that is fraudulent. In addition, the statute allows claimants to obtain awards for attorney's fees. Although this statute has been amended several times in recent years, primarily to address concerns over fraud, the Florida legislature has been only marginally successful in implementing effective mechanisms that allow insurers to combat fraud and other abuses. We believe that this statute contributes to a higher

frequency of claims under nonstandard automobile insurance policies in Florida, as compared to claims under standard automobile insurance policies in Florida and nonstandard and standard automobile insurance polices in other states. Although we believe that we have successfully offset these higher costs with premium increases, because of competition, we may not be able to do so with as much success in the future.

Our success depends on our ability to accurately price the risks we underwrite.

The results of our operations and the financial condition of our insurance companies depend on our ability to underwrite and set premium rates accurately for a wide variety of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, LAE and underwriting expenses and to earn a profit. In order to price our products accurately, we must collect and properly analyze a substantial amount of data; develop, test and apply appropriate rating formulas; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to undertake these efforts successfully, and as a result price our products accurately, is subject to a number of risks and uncertainties, some of which are outside our control, including:

- the availability of sufficient reliable data and our ability to properly analyze available data;

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- the uncertainties that inherently characterize estimates and assumptions;
- our selection and application of appropriate rating and pricing techniques;
- changes in legal standards, claim settlement practices, medical care expenses and restoration costs; and
- legislatively imposed consumer initiatives.

Consequently, we could under-price risks, which would negatively affect our profit margins, or we could overprice risks, which could reduce our sales volume and competitiveness. In either event, the profitability of our insurance companies could be materially and adversely affected.

Current operating resources are necessary to develop future new insurance products

We currently intend to expand our product offerings by underwriting additional insurance products and programs, and marketing them through our distribution network. Expansion of our product offerings will result in increases in expenses due to additional costs incurred in actuarial rate justifications, software and personnel. Offering additional insurance products may also require regulatory approval, further increasing our costs. There can be no assurance that we will be successful bringing new insurance products to our marketplace.

Our business strategy is to avoid competition based on price to the extent possible. This strategy, however, may result in the loss of business in the short term.

Comparable companies which compete with us in the homeowners' market include Allstate Insurance Company, State Farm Insurance Company, First Floridian Insurance Company and Royal Palm Insurance Company. In additional to these nationally recognized names we also compete with several Florida domestic property and casualty companies such as Universal Insurance Company and Coral Insurance Company. Additional competition recently emerged as a result of a January 2007 emergency Florida legislation session wherein, the Florida legislature passed and the Governor signed into law a bill known as "CS/HB-1A." This new law makes fundamental changes to the property and casualty insurance business in Florida and undertakes a multi-pronged approach to address the cost of residential property insurance in Florida. First, the new law requires insurance companies to lower their Florida premium rates for residential property insurance. The new law also authorizes the state-owned insurance company, Citizens, which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance.

Comparable companies which compete with us in the general liability insurance market include Century Surety Insurance Company, Atlantic Casualty Insurance Company, Colony Insurance Company and Burlington/First Financial Insurance Companies.

With respect to automobile insurance in Florida, we compete with more than 100 companies, which underwrite personal automobile insurance. Comparable companies which compete with us in the personal automobile insurance market include Affirmative Insurance Holdings, Inc., which acquired our non-standard automobile agency business in Florida, U.S. Security Insurance Company, United Automobile Insurance Company, Direct General Insurance Company and Security National Insurance Company, as well as major insurers such as Progressive Casualty Insurance Company.

Although our pricing of our insurance products is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our best interest to compete solely on price, choosing instead to compete on the basis of underwriting criteria, our distribution network, and our superior service to our agents and insureds.

Competition could have a material adverse effect on our business, results of operations and financial condition. If we do not meet the prices offered by our competitors, we may lose business in the short term, which could also result in reduced revenues.

Our investment portfolio may suffer reduced returns or losses, which would significantly reduce our earnings.

As do other insurance companies, we depend on income from our investment portfolio for a substantial portion of our earnings. During the time that normally elapses between the receipt of insurance premiums and any payment of insurance claims, we invest the funds received, together with our other available capital, primarily in fixed-maturity investments and equity securities, in order to generate investment income.

Our investment portfolio contains interest rate sensitive instruments, such as bonds, which may be adversely affected by changes in interest rates. A significant increase in interest rates could have a material adverse effect on our financial condition or results of operations. Generally, bond prices decrease as interest rates rise. Changes in interest rates could also have an adverse effect on our investment income and results of operations. For example, if interest rates decline, investment of new premiums received and funds reinvested will earn less than expected.

Our president and chief executive officer is key to the strategic direction of our company. If we were to lose this service our business could be harmed.

We depend, and will continue to depend, on the services of our founder and principal shareholder, Edward J. Lawson, who is also our president, chairman of the board and chief executive officer. We have entered into an employment agreement with him and we maintain $3.0 million key man life insurance on the life of Mr. Lawson. Nevertheless, because of Mr. Lawson's role and involvement in developing and implementing our current business strategy, his loss of service could substantially harm our business.

Our success also will depend in part upon our ability to attract and retain qualified executive officers, experienced underwriting talent and other skilled employees who are knowledgeable about our business. We rely substantially upon the services of our executive management team. Although we are not aware of any planned departures or retirements, if we were to lose the services of members of our management team, our business could be adversely affected. We believe we have been successful in attracting and retaining key personnel throughout our history. We have employment agreements with James G. Jennings III, our Treasurer and Chief Financial Officer, and other members of our executive management team. We also maintain a $1.0 million key man life insurance policy on the life of Mr. Jennings

Risks Related to an Investment in Our Shares

The trading of our warrants may negatively affect the trading prices of our common stock if investors purchase and exercise the warrants to facilitate other trading strategies, such as short selling.

Our warrants currently trade on the NASDAQ Global Market under the symbol “TCHCZ.” Each of the TCHCZ warrants entitles the holders to purchase one share of our common stock at an exercise price per share of $12.75. Investors may purchase and exercise warrants to facilitate trading strategies such as short selling, which involves the sale of securities not yet owned by the seller. In a short sale, the seller must either purchase or borrow the security in order to complete the sale. If shares of our common stock received upon the exercise of warrants are used to complete short sales, this may have the effect of reducing the trading price of our common stock.

Our largest shareholders currently control approximately 10% of the voting power of our outstanding common stock, which could discourage potential acquirers and prevent changes in management.

Edward J. Lawson and Michele V. Lawson beneficially own approximately 10% of our outstanding common stock. As our largest shareholders, the Lawson’s have significant influence over the outcome of any shareholder vote. This

voting power may discourage takeover attempts, changes in our officers and directors or other changes in our corporate governance that other shareholders may desire.

We have authorized but unissued preferred stock, which could affect rights of holders of common stock.

Our articles of incorporation authorize the issuance of preferred stock with designations, rights and preferences determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of common stock. In addition, the preferred stock could be issued as a method of discouraging a takeover attempt. Although we do not intend to issue any preferred stock at this time, we may do so in the future.

Our articles of incorporation, bylaws and Florida law may discourage takeover attempts and may result in entrenchment of management.

Our articles of incorporation and bylaws contain provisions that may discourage takeover attempts and may result in entrenchment of management.

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- Our board of directors is elected in classes, with only two or three of the directors elected each year. As a result, shareholders would not be able to change the membership of the board in its entirety in any one year. Shareholders would also be unable to bring about, through the election of a new board of directors, changes in our officers.

- Our articles of incorporation prohibit shareholders from acting by written consent, meaning that shareholders will be required to conduct a meeting in order to vote on any proposals or take any action.

- Our bylaws require at least 60 days' notice if a shareholder desires to submit a proposal for a shareholder vote or to nominate a person for election to our board of directors.

In addition, Florida has enacted legislation that may deter or frustrate takeovers of Florida corporations, such as our company.

- The Florida Control Share Act provides that shares acquired in a "control share acquisition" will not have voting rights unless the voting rights are approved by a majority of the corporation's disinterested shareholders. A "control share acquisition" is an acquisition, in whatever form, of voting power in any of the following ranges: (a) at least 20% but less than 33-1/3% of all voting power, (b) at least 33-1/3% but less than a majority of all voting power; or (c) a majority or more of all voting power.

- The Florida Affiliated Transactions Act requires supermajority approval by disinterested shareholders of certain specified transactions between a public company and holders of more than 10% of the outstanding voting shares of the corporation (or their affiliates).

As a holding company, we depend on the earnings of our subsidiaries and their ability to pay management fees and dividends to the holding company as the primary source of our income.

We are an insurance holding company whose primary assets are the stock of our subsidiaries. Our operations, and our ability to service our debt, are limited by the earnings of our subsidiaries and their payment of their earnings to us in the form of management fees, commissions, dividends, loans, advances or the reimbursement of expenses. These payments can be made only when our subsidiaries have adequate earnings. In addition, dividend payments made to us by our insurance subsidiaries are restricted by Florida law governing the insurance industry. Generally, Florida law limits the dividends payable by insurance companies under complicated formulas based on the subsidiary's available capital and earnings.

No dividends were declared or paid by our insurance subsidiaries in 2006, 2005 or 2004. Under these laws, neither Federated National nor American Vehicle may be permitted to pay dividends to 21st Century in 2007. Whether our subsidiaries will be able to pay dividends in 2007 depends on the results of their operations and their expected needs for capital. We do not anticipate that our subsidiaries will begin to pay dividends to the parent company during 2007.

ITEM 1B UNRESOLVED STAFF COMMENTS

None

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ITEM 2 PROPERTIES

Our executive offices are located at 3661 West Oakland Park Boulevard, Lauderdale Lakes, Florida in a 39,250 square feet office facility. All of our operations are consolidated within this facility.

Effective March 1, 2005, Federated National sold its interest in the Lauderdale Lakes property to 21st Century at the property's net book value of approximately $2.9 million. Effective on or about March 1, 2006, 21st Century sold the property to an unrelated party for approximately $5.0 million cash and a $0.9 million six year 5% note. As part of the transaction, 21st Century has agreed to lease the same facilities for a six year term. Our lease for this office space expires in December 2011.

We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the lease term.

ITEM 3 LEGAL PROCEEDINGS

We are involved in various claims and legal actions arising in the ordinary course of business. Specifically, we are a party to approximately four lawsuits in connection with coverage disputes associated with claims resulting from Hurricanes Ivan and Jeanne. Hurricane Ivan occurred on September 14, 2004. Hurricane Jeanne occurred on September 25, 2004. During the three months ended September 30, 2006, the resolution of other lawsuits involving similarly styled coverage issues involving other property insurers came to fruition. Accordingly, based on the resolution of these lawsuits involving similarly styled coverage issues we have charged operations with approximately $3.9 million of additional loss and LAE during the quarter ended September 30, 2006. No additional development occurred relative to these claims during the three months ended December 31, 2006.

In 2000 and 2001 respectively, two class action lawsuits were filed against an unaffiliated insurance company for which our subsidiary, Assurance MGA, was the managing general agent. These lawsuits were seeking compensatory damages in an undisclosed amount based on allegations of unfair practices involving the computation of interest due the policyholder in connection with automobile premium refunds. The unaffiliated company has contested these lawsuits over the last several years. Negotiations relative to this matter have been ongoing and in July 2005 the parties reached an agreement wherein we have paid $240,000 to resolve the underlying actions in these suits subject to our contractual duties with respect to the unaffiliated company. We believe that we will be successful in our efforts to enjoin others to participate in this settlement; however we are unable to quantify the participation of others at this time. Accordingly, we charged against second quarter 2005 earnings $240,000 for this action.

In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

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PART II

ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock has been listed for trading on the NASDAQ Global Market under the symbol "TCHC" since November 5, 1998. The following table sets out the high and low closing sale prices as reported on the NASDAQ Global Market. These reported prices reflect inter-dealer prices without adjustments for retail markups, markdowns or commissions.

Quarter Ended		High		Low
March 31, 2006	$	19.50	$	15.85
June 30, 2006	$	19.64	$	12.38
September 30, 2006	$	18.46	$	12.19
December 31, 2006	$	33.75	$	18.02
March 31, 2005	$	14.75	$	12.10
June 30, 2005	$	15.27	$	11.39
September 30, 2005	$	13.64	$	10.87
December 31, 2005	$	17.47	$	11.07

As of March 14, 2007, there were approximately 126 holders of record of our common stock. We believe that the number of beneficial owners of our common stock is in excess of 5,500.

DIVIDENDS

During 2006 and 2005 we have paid quarterly dividends of $0.12 and $0.08 per share, respectively. Payment of dividends in the future will depend on our earnings and financial position and such other factors, as our Board of Directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that Federated National and American Vehicle are permitted to pay to the parent company. All of the foregoing per-share amounts reflect our three-for-two stock split in September 2004.

(d) SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table summarizes our equity compensation plans as of December 31, 2006. All equity compensation plans are approved by stock holders.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans

	(a)		(excluding securities reflected in column (a)) (c)
Equity compensation plans approved by stock holders*	950,017	$ 13.72	1,291,664

*Includes options from the 1998 Stock Option Plan, 2001 Franchise Program Stock Option Plan and the 2002 Stock Option Plan.

For additional information concerning our capitalization please see Note 16 to our Consolidated Financial Statements included under Item 8 of this Report on Form 10-K.

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Issuer Repurchases

The Company did not repurchase any securities during the three month period ended December 31, 2006.

Stock Performance Graph

	Year Ended December 31,					
Index	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
21st Century Holding Company	100.00	439.57	743.12	740.49	889.48	1267.73
NASDAQ Composite	100.00	68.76	103.67	113.16	115.57	127.58
SNL Property & Casualty Insurance Index	100.00	93.80	116.05	127.20	139.05	162.09

Source : SNL Financial LC,
Charlottesville, VA
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Our filings with the SEC may incorporated information by reference, including this Form 10-K. Unless we specifically state otherwise, the information under this heading "Stock Performance Graph" shall not be deemed to be "soliciting materials" and shall not be deemed to be "filed" with the SEC or incorporated by reference into any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934

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ITEM 6 SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Annual Report on Form 10-K.

	As of or for the year ended December 31, (Amounts in 000's except Book value per share and EPS data)				
	2006	2005	2004	2003	2002
Balance sheet data					
Total assets	$ 212,134	$ 290,155	$ 163,601	$ 106,696	$ 75,318
Investments	124,834	100,086	84,382	47,290	25,378
Finance contracts, consumer loans and pay advances receivable, net	1,831	7,313	8,289	9,892	7,218
Total liabilities	145,940	249,387	138,625	74,649	57,220
Unpaid losses and LAE	39,615	154,039	46,571	24,570	16,984
Unearned premiums	77,829	61,839	50,153	34,123	28,934
Revolving credit outstanding	10	197	2,149	4,099	4,312
Total shareholders' equity	66,193	40,767	24,977	32,046	18,098
Book value per share	$ 8.38	$ 6.02	$ 4.13	$ 5.89	$ 4.03
Earnings per share data					
Basic net income (loss) per share from continuing operations	$ 1.84	$ 1.78	$ (2.33)	$ 1.96	$ 1.13
Basic net income (loss) per share from discontinued operations	$ -	$ 0.17	$ 0.47	$ (0.20)	$ (0.12)
Basic net income (loss) per share	$ 1.84	$ 1.95	$ (1.86)	$ 1.76	$ 1.01
Fully diluted net income (loss) per share from continuing operations	$ 1.72	$ 1.67	$ (2.33)	$ 1.85	$ 1.13
Fully diluted net income (loss) per share from discontinued operations	$ -	$ 0.16	$ 0.47	$ (0.18)	$ (0.12)
Fully diluted net income (loss) per share	$ 1.72	$ 1.83	$ (1.86)	$ 1.67	$ 1.01
Cash dividends declared per share	$ 0.48	$ 0.32	$ 0.32	$ 0.25	$ 0.10

21st Century Holding Company

Twelve Months Ended December 31,
(Amounts in 000's except EPS and Dividends)

	2006	2005	2004	2003	2002
Operations Data:					
Revenue:					
Gross premiums written	$ 152,665	$ 119,440	$ 100,662	$ 72,991	$ 63,036
Gross premiums ceded	(67,520)	(31,414)	(15,486)	(22,091)	(27,765)
Net premiums written	85,145	88,026	85,176	50,901	35,271
Increase (decrease) in prepaid reinsurance premiums	20,193	6,623	(2,905)	(3,428)	5,691
(Increase) decrease in unearned premiums	(15,990)	(11,686)	(16,030)	(5,188)	(14,048)
Net change in prepaid reinsurance premiums and unearned premiums	4,203	(5,063)	(18,935)	(8,616)	(8,357)
Net premiums earned	89,348	82,963	66,241	42,285	26,915
Finance revenue	1,686	3,567	3,668	4,328	4,453
Managing general agent fees	2,625	2,420	2,040	2,329	1,970
Net investment income	5,933	3,841	3,172	1,624	1,254
Net realized investment gains (losses)	1,063	458	689	2,231	(1,370)
Other income	3,260	1,419	762	792	770
Total revenue	103,915	94,669	76,571	53,588	33,991
Expenses:					
Loss and loss adjustment expense	44,400	48,336	74,993	27,509	15,987
Operating and underwriting expenses	13,160	8,219	8,140	7,249	6,368
Salaries and wages	7,011	6,384	6,134	5,426	4,562
Interest expense	656	1,398	1,087	607	353
Policy acquisition costs, net of amortization	17,395	14,561	8,423	(854)	(2,064)
Total expenses	82,622	78,899	98,777	39,937	25,206
Income (loss) from continuing operations before provision (benefit) for income tax expense	21,293	15,771	(22,206)	13,652	8,785
Provision (benefit) for income tax expense	7,396	4,690	(8,601)	4,358	3,686
Net income (loss) from continuing operations	13,896	11,081	(13,605)	9,294	5,100

Discontinued operations:										
Income from discontinued operations (including 2005 and 2004 gain on disposal of $1,630 and $5,384, respectively)		-		1,630		4,484		(1,365)		(912)
Provision (benefit) for income tax expense		-		595		1,737		(436)		(383)
Income (loss) from discontinued operations		-		1,035		2,747		(929)		(530)
Net income (loss)	$	13,896	$	12,116	$	(10,858)	$	8,365	$	4,570
Earnings per share data										
Basic net income (loss) per share from continuing operations	$	1.84	$	1.78	$	(2.33)	$	1.96	$	1.13
Basic net income (loss) per share from discontinued operations	$	-	$	0.17	$	0.47	$	(0.20)	$	(0.12)
Basic net income (loss) per share	$	1.84	$	1.95	$	(1.86)	$	1.76	$	1.01
Fully diluted net income (loss) per share from continuing operations	$	1.72	$	1.67	$	(2.33)	$	1.85	$	1.13
Fully diluted net income (loss) per share from discontinued operations	$	-	$	0.16	$	0.47	$	(0.18)	$	(0.12)
Fully diluted net income (loss) per share	$	1.72	$	1.83	$	(1.86)	$	1.67	$	1.01
Cash dividends declared per share	$	0.48	$	0.32	$	0.32	$	0.25	$	0.10

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ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We are an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, control substantially all aspects of the insurance underwriting, distribution and claims process. We are authorized to underwrite personal automobile insurance, commercial general liability insurance, homeowners' property and casualty insurance and mobile home property and casualty insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National and American Vehicle. We internally process claims made by our own and third party insureds through our wholly owned claims adjusting company, Superior. We also offer premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium.

Assurance MGA, a wholly owned subsidiary, acts as Federated National's and American Vehicle's exclusive managing general agent. Assurance MGA currently provides all underwriting policy administration, marketing, accounting and financial services to Federated National and American Vehicle, and participates in the negotiation of reinsurance contracts. Assurance MGA generates revenue through policy fee income and other administrative fees from the marketing of companies' products through our distribution network.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on our business, results of operations and financial condition. Also, if our estimated liabilities for unpaid losses and LAE are less than actual losses and LAE, we will be required to increase reserves with a corresponding reduction in our net income in the period in which the deficiency is identified.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management's evaluation of the determination of liability for unpaid loss and LAE, the amount and recoverability of amortization of deferred policy acquisition costs. In addition, significant estimates form the bases for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates.

The process of determining significant estimates is fact specific and takes into account factors such as historical experience, current and expected economic conditions, and in the case of unpaid loss and LAE, an actuarial valuation. Management regularly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. In selecting the best estimate, we utilize various actuarial methodologies. Each of these methodologies is designed to forecast the number of claims we will be called upon to pay and the amounts we will pay on average to settle those claims. In arriving at our best estimate, our actuaries consider the likely predictive value of the various loss development methodologies employed in light of underwriting practices, premium rate changes and claim

settlement practices that may have occurred, and weight the credibility of each methodology. Our actuarial methodologies take into account various factors, including, but not limited to, paid losses, liability estimates for reported losses, paid allocated loss adjustment expenses, salvage and other recoveries received, reported claim counts, open claim counts and counts for claims closed with and without payment of loss.

Accounting for loss contingencies pursuant to Statements of Financial Accounting Standards ("SFAS"), No.5 involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future event(s) occur or fail to occur. Additionally, accounting for a loss contingency requires management to assess each event as probable, reasonably possible or remote. Probable is defined as the future event or events are likely to occur. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than probable, while remote is defined as the chance of the future event or events occurring is slight. An estimated loss in connection with a loss contingency shall be recorded by a charge to current operations if both of the following conditions are met: First, the amount can be reasonably estimated; and second, the information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability.

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We are required to review the contractual terms of all our reinsurance purchases to ensure compliance with SFAS No. 113, *"Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. The statement establishes the conditions required for a contract with a reinsurer to be accounted for as reinsurance and prescribes accounting and reporting standards for those contracts. Contracts that do not result in the reasonable possibility that the reinsurer may realize a significant loss from the insurance risk assumed generally do not meet the conditions for reinsurance accounting and must be accounted for as deposits. SFAS No. 113 also requires us to disclose the nature, purpose and effect of reinsurance transactions, including the premium amounts associated with reinsurance assumed and ceded. It also requires disclosure of concentrations of credit risk associated with reinsurance receivables and prepaid reinsurance premiums.

Please see Note 2 of the Notes to Consolidated Financial Statements for additional discussions regarding critical accounting policies.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board (FASB) issued interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes" which clarifies the accounting for income tax reserves and contingencies recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact, if any, that FIN 48 will have on its Consolidated Financial Statements. Additionally, we are developing a process to capture and quantify any such effect that FIN 48 could have on the Company.

In February 2006, FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments". This accounting standard permits fair value re-measurement for any hybrid financial instrument containing an embedded derivative that otherwise would require bifurcation; clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; establishes a requirement to evaluate interests in securitized financial assets to identify them as freestanding derivatives or as hybrid financial instruments containing an embedded derivative requiring bifurcation; clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument pertaining to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year beginning after September 15, 2006. There was no impact on our consolidated financial statements with respect to the adoption of SFAS No. 155.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements", which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect any impact upon the adoption of SFAS No. 157 on our consolidated financial statements.

In September 2006, FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." This statement requires an employer to recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in the funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 will become effective for years ending after December 15, 2006. There was no impact on our consolidated

financial statements with respect to the adoption of SFAS No. 158.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108 to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires that registrants quantify the impact on the current year's financial statements of correcting all misstatements, including the carryover and reversing effects of prior years' misstatements, as well as the effects of errors arising in the current year. SAB 108 is effective as of the first fiscal year ending after November 15, 2006, allowing a one-time transitional cumulative effect adjustment to retained earnings as of January 1, 2006, for errors that were not previously deemed material, but are material under the guidance in SAB No. 108. There was no impact on our consolidated financial statements with respect to the adoption of SAB No. 108.

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In November 2005, the FASB released FASB Staff Position Nos. FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("FSP 115-1"), which effectively replaces EITF Issue No. 03-1. FSP 115-1 contains a three-step model for evaluating impairments and carries forward the disclosure requirements in EITF Issue No. 03-1 pertaining to securities in an unrealized loss position is considered impaired; an evaluation is made to determine whether the impairment is other-than-temporary; and, if an impairment is considered other-than-temporary, a realized loss is recognized to write the security's cost or amortized cost basis down to fair value. FSP 115-1 references existing other-than-temporary impairment guidance for determining when impairment is other-than-temporary and clarifies that subsequent to the recognition of other-than-temporary impairment loss for debt securities, an investor shall account for the security using the constant effective yield method. FSP 115-1 is effective for reporting periods beginning after December 15, 2005, with earlier application permitted. There was no impact on our consolidated financial statements with respect to the adoption of FSP 115-1.

In September 2005, the AICPA issued Statement of Position 05-1, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in connection with Modifications or Exchanges of Insurance Contracts" ("SOP 05-1"). This statement provides guidance to insurance entities that incur deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in SFAS No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments.* SOP 05-1 defines internal replacements as modifications in product benefits, features, rights, or coverage that occur by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage with a contract. The accounting treatment for such replacements depends on whether, under the provisions of the SOP, the replacement contract is considered substantially changed from the replaced contract. A substantial change would be treated as the extinguishment of the replaced contract, and all unamortized deferred acquisition costs, unearned revenue liabilities, and deferred sales inducement assets from the replaced contract would no longer be deferred in connection with the replacement contract. A replacement contract that is substantially unchanged should be accounted for as a continuation of the original contract. SOP 05-1 will be effective for internal replacements occurring in fiscal years beginning after December 15, 2006, with earlier adoption encouraged. The Company adopted this statement beginning with the fiscal quarter beginning January 1, 2006. There was no impact on our consolidated financial statements with respect to the adoption of SOP 05-1.

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS, No. 123, Share-Based Payments (revised 2004) ("SFAS No. 123R"). This statement eliminates the option to apply the intrinsic value measurement provisions of APB No. 25 to stock compensation awards issued to employees. Rather, SFAS No. 123R requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award - the requisite service period (usually the vesting period). SFAS No. 123R will also require companies to measure the cost of employee services received in exchange for employee stock purchase plan awards. SFAS No. 123R became effective for 21st Century's fiscal quarter beginning January 1, 2006. The effect on operations for the year ended December 31, 2006 was a pretax charge totaling $539,000 or a $0.05 per share basic and $0.04 per share on a fully diluted basis.

In April 2005, the Securities and Exchange Commission's Office of the Chief Accountant and its Division of Company Finance has released Staff Accounting Bulletin ("SAB") No.107 to provide guidance regarding the application of FASB Statement No. 123 (revised 2004), Share-Based Payment. Statement No. 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SAB 107 provides interpretative guidance related to the interaction between Statement No. 123R and certain SEC rules and regulations, as well as the staff's views regarding the valuation of share-based payment arrangements for public companies.

In May 2005, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 154, “Accounting Changes and Error Corrections-a replacement of APB Opinion No. 20 and FASB Statement No. 3” (“SFAS 154”). This Statement replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed.

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APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this Statement requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, this Statement requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. This Statement shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 did not have a significant effect on our financial statements.

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ANALYSIS OF FINANCIAL CONDITION
As of December 31, 2006 as Compared to December 31, 2005

Total Investments

SFAS No. 115 addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. SFAS 115 requires that these securities be classified into one of three categories, Held-to-maturity, Trading securities or Available-for-sale.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity. The accounting treatment for held-to-maturity investments is to carry them at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for the sale in the near term. The accounting treatment for trading securities is to carry them at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income".

Total Investments increased $24.7 million, or 24.7%, to $124.8 million as of December 31, 2006, as compared to $100.1 million as of December 31, 2005. The increase is primarily a result of our investment of the proceeds from an increase in written insurance premiums.

The fixed maturities and the equity securities that are available for sale and carried at fair value represent 84.2% of total investments as of December 31, 2006, as compared to 80.3% as of December 31, 2005.

We did not hold any non-traded investment securities during 2006 or 2005.

Below is a summary of net unrealized gains and (losses) at December 31, 2006 and December 31, 2005 by category.

	Net Unrealized Gains (Losses) Years Ended December 31, 2006	2005
Fixed maturities:		
U.S. government obligations	$ (688,190)	$ (618,704)
Obligations of states and political subdivisions	(145,505)	(135,305)
	(833,695)	(754,009)
Corporate securities:		
Communications	6,842	14,735
Financial	(18,790)	(225,768)
Other	(73,983)	(19,682)
	(85,931)	(230,715)
Equity securities:		
Common stocks	(631,000)	(1,479,994)
Total fixed, corporate and equity securities	$ (1,550,626)	$ (2,464,718)

During December 2005, we classified $19.7 million of our bond portfolio as held-to-maturity. The decision to classify this layer of our bond portfolio as held-to-maturity was predicated on our intention to establish an irrevocable letter of credit in order to facilitate business opportunities in connection with our commercial general liability program. During April 2006, American Vehicle finalized the irrevocable letter of credit in conjunction with the 100% Quota Share Reinsurance Agreement with Republic Underwriters Insurance Company.

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Pursuant to FASB 115, the Company records the unrealized losses, net of estimated income taxes that are associated with that part of our portfolio classified as available for sale through the Shareholders' equity account titled Other Comprehensive Income. Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost is either other than temporary or permanently impaired. Factors used in such consideration include, but are not limited to, the extent and length of time over which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our ability and intent to keep the investment for a period sufficient to allow for an anticipated recovery in market value.

In reaching a conclusion that a security is either other than temporary or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principle and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's and Moody's as well as information released via the general media channels.

The investments held at December 31, 2006 and December 31, 2005 were comprised mainly of United States government and agency bonds as well as municipal bonds which are viewed by the Company as conservative and less risky holdings, though sensitive to interest rate changes. There is a smaller concentration of corporate bonds predominantly held in the financial and conglomerate industries. All of the equity holdings are in income funds.

All of our securities are in good standing and are not impaired as defined by FASB 115. We have determined that none of our securities qualify for other than temporary impairment or permanent impairment status. Our rational for this determination includes, but is not limited to, Standard and Poor's rating of no less than BB++, no delinquent interest and dividend payments, near term maturity dates and our ability and intent to hold these securities for a period sufficient to allow for an anticipated recovery in market value.

Cash and Short Term Investments

Cash and short term investments, which include cash, certificates of deposits, and money market accounts increased $11.8 million, or 195.1%, to $17.9 million as of December 31, 2006, as compared to $6.1 million as of December 31, 2005. These balances are held primarily in money market accounts and are available for the settlement of hurricanes related claims.

Finance Contracts Receivable, Net of Allowance for Credit Losses

Finance contracts receivable, net of allowance for credit losses, decreased $5.5 million, or 75.0%, to $1.8 million as of December 31, 2006, as compared to $7.3 million as of December 31, 2005. The decrease is primarily due to our sale in December 2004 of our assets related to our non-standard automobile insurance agency business in Florida and the associated financed contracts. We anticipate a continued decline in the financed contracts receivable, net over the future short term and its related conversion to cash and investments.

Prepaid Reinsurance Premiums

Prepaid reinsurance premiums increased $26.8 million, or 220.8%, to $38.9 million as of December 31, 2006, as compared to $12.1 million as of December 31, 2005. The increase is due to our payments and amortization of prepaid reinsurance premiums associated with our homeowners' book of business.

Premiums Receivable, Net of Allowance for Credit Losses

Premiums receivable, net of allowance for credit losses, decreased $0.3 million, or 3.8%, to $7.2 million as of December 31, 2006, as compared to $7.5 million as of December 31, 2005.

Our homeowners' insurance premiums receivable increased $0.9 million, or 47.4%, to $4.2 million as of December 31, 2006, as compared to $1.9 million as of December 31, 2005. The increase can be attributed to the seasonality of the purchasing patterns of our policy holders.

Our commercial general liability insurance premiums receivable increased $0.4 million, or 19.0%, to $2.7 million as of December 31, 2006, as compared to $2.3 million as of December 31, 2005.

Premiums receivable in connection with our automobile line of business decreased $3.0 million, or 72.3%, to $1.2 million as of December 31, 2006, as compared to $4.2 million as of December 31, 2005. The decrease in automobile related premiums receivable is associated with the sale of our distribution channels in connection with the sale of our agencies, effective December 31, 2004.

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Reinsurance Recoverable, Net

Reinsurance recoverable, net, decreased to nothing as of December 31, 2006, as compared to $136.7 million as of December 31, 2005. The decrease is due to the timing of settlements with our reinsurers in connection with the adjustment of loss and LAE claims as they relate to costs recoverable under our reinsurance agreements.

Deferred Policy Acquisition Costs

Deferred policy acquisition costs increased $2.0 million, or 21.4%, to $11.2 million as of December 31, 2006, as compared to $9.2 million as of December 31, 2005. The increased production volume for both the homeowners' and commercial general liability product lines is the reason for the increase to this asset.

Deferred Income Taxes, Net

Deferred income taxes, net, increased $0.9 million, or 33.5%, to $3.6 million as of December 31, 2006, as compared to $2.7 million as of December 31, 2005. The increase is comprised primarily of $1.5 million related to regulatory assessments and $0.9 million in connection with the sale of our property in Lauderdale Lakes, offset by $0.8 million in connection with deferred policy acquisition costs, $0.4 million related to allowance for credit losses and $0.3 in connection with our investment portfolio.

Income Taxes Receivable

Income taxes receivable increased to $0.8 million as of December 31, 2006, as compared to nothing as of December 31, 2005. The change is due to tax payment patterns in connection with our tax liabilities.

Property, Plant and Equipment, Net

Property, plant and equipment, net, decreased $2.6 million, or 66.8%, to $1.3 million as of December 31, 2006, as compared to $3.9 million as of December 31, 2005. Effective on or about March 1, 2006, 21st Century sold its interest in the Lauderdale Lakes property to an unrelated party for approximately $5.0 million cash and a $0.9 million six year 5% note, generating a gain on sale totaling approximately $2.9 million. As part of the transaction, 21st Century has agreed to lease the same facilities for a six year term. Our lease for this office space expires in December 2011. The Company recognized a deferred gain in connection with the sale totaling approximately $2.8 million.

Other Assets

Other assets remained at $4.6 million as of December 31, 2006, as compared to $4.6 million as of December 31, 2005. Major components of other assets are as follows:

	December 31, 2006	December 31, 2005
Accrued interest income	$ 1,515,584	$ 734,059
Notes receivable	1,027,958	-
Revenue sharing due from reinsurer	979,677	234,552
Unamortized loan costs	61,572	310,832
Compensating cash balances	9,911	363,021
Due from sale of discontinued operations, net	320,000	410,000

Prepaid expenses		531,008		349,138
Recoupment of assessments		-		2,025,210
Other		110,642		153,251
Total	$	4,556,352	$	4,580,063

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Unpaid Losses and LAE

Unpaid losses and LAE decreased $114.4 million, or 74.3%, to $39.6 million as of December 31, 2006, as compared to $154.0 million as of December 31, 2005. The decrease in unpaid losses and LAE relates to our payment patterns primarily relative to the settling of hurricane related claims. The composition of unpaid loss and LAE by product line is as follows:

		December 31, 2006		December 31, 2005
Homeowners'	$	21,788,126	$	135,173,026
Commercial General Liability		11,100,116		3,661,256
Automobile		6,727,236		15,204,261
	$	39,615,478	$	154,038,543

Factors that affect unpaid losses and LAE include the estimates made on a claim-by-claim basis known as "case reserves" coupled with bulk estimates known as IBNR. Periodic estimates by management of the ultimate costs required to settle all claim files are based on the Company's analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

Unearned Premium

Unearned premiums increased $16.0 million, or 25.9%, to $77.8 million as of December 31, 2006, as compared to $61.8 million as of December 31, 2005. The increase was due to an $18.9 million increase in unearned homeowners' insurance premiums, a $4.5 million increase in unearned commercial general liability premiums, and a $7.4 million decrease in unearned automobile premiums. These changes reflect our continued emphasis in 2006 on property and commercial general liability insurance products.

Due to Reinsurers, Net

Due to reinsurers, net increased to $4.2 million as of December 31, 2006, as compared to nothing as of December 31, 2005 at which time the Company had an asset, Reinsurance recoverable, net. Due to the lack of catastrophic events in 2006, loss recoveries were not sufficiently greater than premiums due reinsurers, resulting in a net payable for the year ended December 31, 2006.

Premium Deposits and Customer Credit Balances

Premium deposits and customer credit balances increased $1.6 million, or 76.8%, to $3.8 million as of December 31, 2006, as compared to $2.1 million as of December 31, 2005. Premium deposits are monies received on policies not yet in force as of December 31, 2006. The change is due to our policyholders purchasing patterns, the Company's marketing efforts and our policies renewal patterns.

Revolving Credit Outstanding

Revolving credit outstanding decreased to nearly nothing as of December 31, 2006, as compared to $0.2 million as of December 31, 2005. The decrease is due to our cash management efforts, our requested credit reduction, and sale in December 2004 of our assets related to our non-standard automobile insurance agency business in Florida and the derived finance contracts receivable.

Bank Overdraft

Bank overdraft decreased $4.1 million, or 33.8%, to $8.1 million as of December 31, 2006, as compared to $12.2 million as of December 31, 2005. The bank overdraft relates to primarily to loss and LAE disbursements paid but not yet presented for payment by the policyholder or vendor. The decrease relates to our payment patterns in relationship to the rate at which those cash disbursements are presented to the bank for payment.

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Funds Held Under Reinsurance Treaties

Funds held under reinsurance treaties were returned to our reinsurer as of December 31, 2006, as compared to $1.5 million balance as of December 31, 2005. During its regularly scheduled meeting on August 17, 2005, the Board of Governors of Citizens determined a 2004 plan year deficit existed in their High Risk Account. Citizen's Board decided that a $515 million Regular Assessment was in the best interest of Citizens and consistent with Florida Statutes. On this basis, Citizen's Board certified for a Regular Assessment. Federated National's participation in this assessment totaled $2.0 million. Provisions contained in our excess of loss reinsurance policies provided for their participation totaling $1.5 million of our $2.0 million assessment.

Income Taxes Payable

Income taxes payable decreased to nothing as of December 31, 2006, as compared to $3.0 million as of December 31, 2005. The change is due to tax payment patterns in connection with our tax liabilities.

Subordinated Debt

Subordinated Debt decreased $6.0 million, or 59.2%, to $4.2 million as of December 31, 2006, as compared to $10.2 million as of December 31, 2005. The decrease is in connection with the retirement of the 2003 notes on July 31, 2006 and the scheduled quarterly principal payments on the 2004 notes.

Deferred Gain from Sale of Property

Deferred gain from sale of property increased to $2.5 million as of December 31, 2006 as compared to nothing as of December 31, 2005. In accordance with the provisions of FASB No. 13, we will amortize the deferred gain over the term of the lease-back which is scheduled to end in December 2011.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses increased $1.6 million, or 37.5%, to $5.7 million as of December 31, 2006 as compared to $4.2 million as of December 31, 2005. This increase is due to our cash management efforts and timing of payments with our trade vendors.

RESULTS OF OPERATIONS
Year Ended December 31, 2006 as Compared to Year Ended December 31, 2005

Gross Premiums Written

Gross premiums written increased $33.2 million, or 27.8%, to $152.7 million for the year ended December 31, 2006, as compared to $119.4 million for year ended December 31, 2005. The following table denotes gross premiums written by major product line.

	Years Ended December 31,			
	2006		2005	
	Amount	Percentage	Amount	Percentage
Homeowners'	$ 114,388,069	74.93%	$ 76,181,988	63.78%
Commercial General Liability	32,213,179	21.10%	22,593,477	18.92%

Automobile		6,063,645	3.97%		20,664,832	17.30%
Gross written premiums	$	152,664,893	100.00%	$	119,440,297	100.00%

As noted above, the Company's efforts to expand commercial general liability lines of insurance products are coming to fruition, as reflected by increased premiums written of $9.6 million, or 42.6 % to $32.2 million for the year ended December 31, 2006, as compared to $22.6 million for the year ended December 31, 2005.

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state:

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	Years Ended December 31,			
	2006		2005	
	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)			
State				
Florida	$ 22,965	71.29%	$ 18,293	80.97%
Georgia	1,805	5.60%	1,258	5.57%
Kentucky	9	0.03%	-	0.00%
Lousiania	5,743	17.83%	3,042	13.46%
South Carolina	77	0.24%	-	0.00%
Texas	1,604	4.98%	-	0.00%
Virginia	10	0.03%	-	0.00%
Total	$ 32,213	100.00%	$ 22,593	100.00%

The Company's sale of homeowners' policies increased $38.2 million, or 50.2%, to $114.4 million for the year ended December 31, 2006, as compared to $76.2 million for year ended December 31, 2005. The increase in homeowners' gross premiums written is primarily due to the Company's rate increase, with only a slight increase in the number of policy holders.

The Company's sale of auto insurance policies decreased $14.6 million, or 70.7%, to $6.1 million for the year ended December 31, 2006, as compared to $20.7 million for year ended December 31, 2005.

Gross Premiums Ceded

Gross premiums ceded increased to a debit balance of ($67.5) million for the year ended December 31, 2006, as compared to a debit balance of ($31.4) million for year ended December 31, 2005. The increase is associated with the change in our prepaid reinsurance premiums in connection with our 2006-2007 hurricane season. For further discussion please see Footnote 6 titled "Reinsurance Agreements".

Increase in Prepaid Reinsurance Premiums

The increase in prepaid reinsurance premiums was $20.2 million for the year ended December 31, 2006, as compared to $6.6 million for year ended December 31, 2005. The increased credit to written premium is primarily associated with the timing of our reinsurance payments measured against the term of the underling reinsurance policies.

(Increase) in Unearned Premiums

The (increase) in unearned premiums was ($16.0) million for the year ended December 31, 2006, as compared to ($11.7) million for year ended December 31, 2005. The change was due to an $18.9 million increase in unearned homeowners' insurance premiums, a $4.6 million increase in unearned commercial general liability premiums, and a $7.4 million decrease in unearned automobile premiums. These changes reflect our continued growth along our homeowners' and commercial general liability lines of business. For further discussion, see "Analysis of Financial Condition - Unearned Premiums" on page 47.

Net Premiums Earned

Net premiums earned increased $6.4 million, or 7.7%, to $89.3 million for the year ended December 31, 2006, as compared to $83.0 million for year ended December 31, 2005. The following table denotes net premiums earned by major product line.

	Years Ended December 31,			
	2006		2005	
	Amount	Percentage	Amount	Percentage
Homeowners'	$ 48,206,614	53.95%	$ 40,386,025	48.68%
Commercial General Liability	27,658,007	30.96%	18,212,251	21.95%
Automobile	13,483,633	15.09%	24,365,220	29.37%
Net premiums earned	$ 89,348,254	100.00%	$ 82,963,496	100.00%

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As noted above, the Company's efforts to expand commercial general liability lines of insurance products are coming to fruition, as reflected by increased net premiums earned of $9.4 million, or 51.9 % to $27.7 million for the year ended December 31, 2006, as compared to $18.2 million for the year ended December 31, 2005.

Finance Revenue

Finance revenue decreased $1.9 million, or 52.7%, to $1.7 million for the year ended December 31, 2006, as compared to $3.6 million for year ended December 31, 2005. The decrease is primarily due to the sale in December 2004 of our assets related to our non-standard automobile insurance agency business in Florida and the finance revenue derived there from. We expect a continuing decline in finance revenue over the near future.

Managing General Agent Fees

Managing general agent fees increased $0.2 million, or 8.5%, to $2.6 million for the year ended December 31, 2006, as compared to $2.4 million for year ended December 31, 2005.

Net Investment Income

Net investment income increased $2.1 million, or 54.5%, to $5.9 million for the year ended December 31, 2006, as compared to $3.8 million for year ended December 31, 2005. The increase in investment income is primarily a result of the additional amounts of invested assets. Also affecting our net investment income was an increase in overall yield to 6.22% for the year ended December 31, 2006 as compared to a yield of 4.66% for the year ended December 31, 2005.

Net Realized Investment Gains

Net realized investment gains increased $0.6 million, or 131.9%, to $1.1 million for the year ended December 31, 2006, as compared to $0.5 million for year ended December 31, 2005. The table below depicts the gains (losses) by investment category.

	Years Ended December 31,	
	2006	2005
Realized gains:		
Fixed securities	$ 151	$ 36,981
Equity securities	1,471,307	664,162
Total realized gains	1,471,458	701,143
Realized losses:		
Fixed securities	(66,722)	(136,570)
Equity securities	(341,874)	(106,267)
Total realized losses	(408,596)	(242,837)
Net realized gains (losses) on investments	$ 1,062,862	$ 458,306

Other Income

Other income increased $1.8 million, or 129.7%, to $3.3 million for the year ended December 31, 2006, as compared to $1.4 million for year ended December 31, 2005. Major components of other income for the year ended December 31, 2006 included approximately $1.4 million of commissions in connection with the acquisition of our current reinsurance program, $0.5 million in partial recognition of our gain on the sale of our Lauderdale Lakes property, $0.3 million of commissions in connection with our prior sale of agency operations, $0.3 million of commissions in connection with the national flood insurance program, $0.2 million in connection with a legal settlement, $0.2 million of business interruption recovery, $0.1 million in connection with FIGA fees, $0.1 million of rental income and $0.2 million of miscellaneous other sources.

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Loss and LAE

Loss and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. We revise our estimates based on the results of analysis of estimated future payments to be made. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.

Loss and LAE decreased by $3.9 million, or 8.1%, to $44.4 million for the year ended December 31, 2006, as compared to $48.3 million for year ended December 31, 2005. The decrease is attributable to the increase in loss and LAE incurred during the year ended December 31, 2005 which was in connection with the adverse development associated with the 2004 hurricanes.

We continue to revise our estimates of the ultimate financial impact of past storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

The table below reflects a recovery to operations of $0.1 million during the year ended December 31, 2006 from the four hurricanes that occurred in July, August, September and October of 2005.

2005 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Dennis (July 10)	-	$ -	$ -	$ -
Katrina (August 25)	37	(0.1)	(0.1)	-
Rita (September 20)	(5)	(0.1)	-	(0.1)
Wilma (October 24)	1,517	26.0	26.0	-
Total Loss Estimate	1,549	$ 25.8	$ 25.9	$ (0.1)

The following table reflects the changes during the year ended December 31, 2006 in connection with the four hurricanes that occurred in August and September of 2004. A charge of $5.4 million occurred during the year ended December 31, 2006 in connection with these storms.

2004 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Charley (August 13)	6	$ 3.6	$ 3.6	$ -
Frances (September 3)	4	3.2	3.1	0.1
Ivan (September 14)	(3)	4.5	-	4.5
Jeanne (September 25)	14	0.9	-	0.9

Total Loss Estimate	21	$	12.2	$	6.7	$	5.5

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Our loss ratio, as determined in accordance with GAAP, for the year ended December 31, 2006 was 49.7%, as compared to 58.3% for the year ended December 31, 2005. The table below reflects the loss ratios by product line.

	Years Ended December 31,	
	2006	2005
Homeowners'	46.7%	65.5%
Commercial General Liability	38.2%	19.1%
Automobile	84.0%	75.5%
All lines	49.7%	58.3%

For further discussion, see the Note 7 to the Consolidated Financial Statements included under Part II, Item 8, of this Report.

Operating and Underwriting Expenses

Operating and underwriting expenses increased $4.9 million, or 60.1%, to $13.2 million for the year ended December 31, 2006, as compared to $8.2 million for year ended December 31, 2005. The change is primarily due to a charge to operations of $3.9 million in connection with a FIGA assessment and premium tax expense which increased $1.0 million. Approvals by the OIR to recoup the assessment through an average 1.0% policy surcharge on all of our policies written in Florida over a twelve month period for new and renewal business have been granted. Premium tax expense is directly correlated to written premium, which experienced an increase in 2006.

Salaries and Wages

Salaries and wages increased $0.6 million, or 9.8%, to $7.0 million for the year ended December 31, 2006, as compared to $6.4 million for year ended December 31, 2005. As a result of the adoption of SFAS No. 123R on January 1, 2006, salaries and wages for the year ended December 31, 2006 include a $0.5 million charge, representing approximately 85.9% of the 2006 overall increase. The remaining increase in salaries and wages was due in part to the increased labor costs in connection with additional claims loss adjusters added to our staff. We believe that salaries and wages are consistent with retaining quality management and increased premium production.

Interest Expense

Interest expense decreased $0.7 million, or 53.1%, to $0.7 million for the year ended December 31, 2006, as compared to $1.4 million for year ended December 31, 2005. The change is primarily attributed to our decreased reliance upon outside sources for financing our contracts receivable.

Policy Acquisition Costs, Net of Amortization

Policy acquisition costs, net of amortization, increased $2.8 million, or 19.5%, to $17.4 million for the year ended December 31, 2006, as compared to $14.6 million for year ended December 31, 2005. Policy acquisition costs, net of amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned.

Provision for Income Tax Expense

The provision for income tax expense for continuing and discontinued operations increased $2.1 million, or 39.9%, to $7.4 million for the year ended December 31, 2006, as compared to $5.3 million for the year ended December 31, 2005. The effective rate for income tax expense is 34.7% for the year ended December 31, 2006, as compared to 30.4% for the year ended December 31, 2005.

Net Income

As a result of the foregoing, the Company's net income for the year ended December 31, 2006 was $13.9 million compared to net income of $12.1 million for year ended December 31, 2005.

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RESULTS OF OPERATIONS
Year Ended December 31, 2005 as Compared to Year Ended December 31, 2004

Gross Premiums Written

Gross premiums written increased $18.8 million, or 18.7%, to $119.4 million for the year ended December 31, 2005, as compared to $100.7 million for the comparable period in 2004. The following table denotes gross premiums written by major product line.

	Year Ended December 31,			
	2005		2004	
Automobile	$ 20,664,832	17.30%	$ 24,239,000	24.08%
Homeowners'	75,741,414	63.41%	62,400,283	61.99%
Commercial General Liability	22,593,477	18.92%	12,509,943	12.43%
Mobile home owners'	440,574	0.37%	1,512,799	1.50%
Gross written premiums	$ 119,440,297	100.00%	$ 100,662,025	100.00%

As noted above, the Company's efforts to expand commercial general liability lines of insurance products are coming to fruition, as reflected by increased premiums written of $22.6 million for the year ended December 31, 2005, as compared to $12.5 million for the same period in the prior year. Furthermore, these policies reflect an increased percentage of the Company's total gross premiums written, increasing to 18.9% of total premiums written in the year ended December 31, 2005, as compared to 12.42% in the same period of fiscal 2004.

The Company's sale of homeowners' policies increased $13.3 million, or 21%, to $75.7 million for the year ended December 31, 2005, as compared to $62.4 million in the same period of fiscal 2004. The increase in our homeowners' gross premium written is primarily due to the Company's rate increase of 22.4% that was affected December 1, 2004. The approximate average premium on the policies currently in force is approximately $1,849, as compared to $1,571 for 2004, and the typical deductible is $1,000 for non-hurricane-related claims and generally 2% of the coverage amount for the structure for hurricane-related claims. The Company increased its rates again by an average 14.9% as of December 31, 2005.

The Company's sale of auto insurance policies is relatively steady with premiums relatively constant at $20.7 million for the year ended December 31, 2005, as compared to $24.2 million in the same period of fiscal 2004, despite the sale of the Company's captive agents who handled most of the auto insurance policies.

In 2004, the Company made a conscious decision to decrease its sale of mobile home policies and consequently, its sales of these policies have decreased to $0.4 million in the year ended December 31, 2005, representing 0.37% of total premiums written.

Gross Premiums Ceded

Gross premiums ceded increased $15.9 million, or 102.9%, to $31.4 million for the year ended December 31, 2005, as compared to $15.5 million for the year ended December 31, 2004. The change is associated with our increased homeowners' insurance premium volume and our reinsurance costs.

Increase in Prepaid Reinsurance Premiums

The increase in prepaid reinsurance premiums was $6.6 million for the year ended December 31, 2005, as compared to the decrease in prepaid reinsurance premiums of $2.9 million for the year ended December 31, 2004. The increased credit toward written premium is primarily associated with the timing of our reinsurance payments measured against the term of the underlying reinsurance policies.

Increase in Unearned Premiums

The increase in unearned premiums was $11.7 million for the year ended December 31, 2005, as compared to $16.0 million for the year ended December 31, 2004. The increase in unearned premiums of $11.7 million for the year ended December 31, 2005 was due to an $11.5 million increase in unearned homeowners' insurance premiums, a $4.4 million increase in unearned commercial liability premiums, a $3.7 million decrease in unearned automobile premiums, and a $0.5 million decrease in unearned mobile home insurance premiums. These changes reflect our continued growth along our homeowners' and commercial general liability lines of business. For further discussion, see "Unearned Premiums" above.

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Finance Revenue

Finance revenue decreased $0.1 million, or 2.8%, to $3.6 million for the year ended December 31, 2005, as compared to $3.7 million for the year ended December 31, 2004. The modest decrease is primarily due to the sale in December 2004 of our assets related to our non-standard automobile insurance agency business in Florida and the finance revenue derived there from.

Managing General Agent Fees

Managing general agent fees increased $0.4 million, or 18.6%, to $2.4 million for the year ended December 31, 2005, as compared to $2.0 million for the year ended December 31, 2004. The change reflects an overall increase in the production of insurance policies with higher rates.

Net Investment Income

Net investment income increased $0.7 million, or 21.1%, to $3.8 million for the year ended December 31, 2005, as compared to $3.2 million for the year ended December 31, 2004. The increase in investment income is primarily a result of the additional amounts of invested assets, offset by a modest decrease in overall yield to 4.16% for the year ended December 31, 2005, as compared to a yield of 4.82% for the year ended December 31, 2004.

Net Realized Investment Gains

Net realized investment gains decreased by $0.2 million, or 33.5%, to $0.5 million for the year ended December 31, 2005, as compared $0.7 million for the year ended December 31, 2004. The table below reflects the gains and losses by investment category.

	Years Ended December 31,			
	2005		2004	
Realized gains:				
Fixed securities	$	36,981	$	62,513
Equity securities		664,162		894,883
Total realized gains		701,143		957,396
Realized losses:				
Fixed securities		(136,570)		(42,911)
Equity securities		(106,267)		(225,809)
Total realized losses		(242,837)		(268,720)
Net realized gains (losses) on investments	$	458,306	$	688,676

Other Income

Other income increased by $0.7 million, or 86.3%, to $1.4 million for the year ended December 31, 2005, as compared to $0.8 million for the year ended December 31, 2004. During the year ended December 31, 2005, the Company recognized other income totaling $0.4 million (net of $0.7 million valuation allowance) in connection with the recognition of deferred gain stemming from the sale of certain assets and liabilities relative to the agency operations. Additional components contained in other income include $0.3 million in building rents for both years

ended December 31, 2005 and 2004, and commission based fee income from various arrangements totaling $0.7 million and $0.5 million for the years ended December 31, 2005 and 2004, respectively.

Loss and LAE

Loss and LAE decreased by $26.7 million, or 35.5%, to $48.3 million for the year ended December 31, 2005, as compared to $75.0 million as of December 31, 2004. The decrease is due primarily to the Company’s reinsurance retention philosophy in connection with the frequency and severity stemming from the four hurricanes that occurred in July, August September and October of 2005, and the four hurricanes that occurred in August and September of 2004 which were partially offset by the impact of the improved automobile loss experience due to management’s efforts to migrate from predominately liability only policies to full-coverage type automobile policies.

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Management continues to revise our estimates of the ultimate financial impact of these storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) Company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

The table below reflects a charge to current year earnings of $8.9 million, net of reinsurance recoveries of $146.6 million, stemming from the four hurricanes that occurred during the year ended December 31, 2005 as indicated below.

2005 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Dennis (July 10)	322	$ 2.7	$ -	$ 2.7
Katrina (August 25)	2,076	14.6	11.6	3.0
Rita (September 20)	24	0.2	-	0.2
Wilma (October 24)	10,039	138.0	135.0	3.0
Total Loss Estimate	12,461	$ 155.5	$ 146.6	$ 8.9

The table below reflects a charge to current year earnings of $10.6 million, net of reinsurance recoveries of $27.8 million, stemming from the four hurricanes that occurred in August and September of 2004.

2004 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Charley (August 13)	129	$ 15.3	$ 15.3	$ -
Frances (September 3)	480	12.5	12.5	-
Ivan (September 14)	45	7.3	-	7.3
Jeanne (September 25)	(108)	3.3	-	3.3
Total Loss Estimate	546	$ 38.4	$ 27.8	$ 10.6

Our loss ratio, as determined in accordance with GAAP, for the year ended December 31, 2005 was 58.26% compared with 113.21% for the same period in 2004. The table below reflects the loss ratios by product line.

	Years Ended December 31,	
	2005	2004
Automobile	74.89%	73.18%
Homeowners'	65.89%	171.30%
Commercial General Liability	19.10%	18.74%
All lines	58.26%	113.21%

Loss and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. Management revises its estimates based on the results of its analysis of estimated future payments to be made. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.

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For further discussion, see the Note 7 to the Consolidated Financial Statements included under Part II, Item 8, of this Report.

Operating and Underwriting Expenses

Operating and underwriting expenses increased $0.1 million, or 1.0%, to $8.2 million for the year ended December 31, 2005, as compared to $8.1 million for the year ended December 31, 2004. The modest increase is primarily due to premium taxes, which increased $0.6 million, or 43.1%, to $1.9 million for the year ended December 31, 2005, as compared to $1.3 million for the year ended December 31, 2004. Premium tax expense is directly correlated to written premium, which experienced an increase over 2004.

Salaries and Wages

Salaries and wages increased $0.2 million, or 4.1%, to $6.4 million for the year ended December 31, 2005, as compared to $6.1 million for the year ended December 31, 2004. Management believes that the modest increase in salaries and wages was due in part to the increased labor costs in connection with additional claims loss adjusters added to our staff. Management further believes that salaries and wages are consistent with retaining quality management and increased premium production.

Interest Expense

Interest expense increased by $0.3 million, or 28.5%, to $1.4 million for the year ended December 31, 2005, as compared to $1.1 million as of December 31, 2004. The increase in interest expense is attributed to approximately $0.4 million associated with the July 2003 and September 2004 Notes, mitigated by a decrease totaling approximately $0.1 million in interest expense in connection with our reliance upon outside sources for financing our contracts receivable.

Policy Acquisition Costs, Net of Amortization

Policy acquisition costs, net of amortization, increased $6.1 million, or 72.9%, to $14.6 million for year ended December 31, 2005, as compared to $8.4 million for the year ended December 31, 2004. Policy acquisition costs, net of amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned.

The increase in policy acquisition costs, net of amortization, is primarily attributable to the sale of our captive agencies in December of 2004, wherein our cost of acquiring policies from those agencies will no longer be eliminated under the principles of consolidation.

Net Income (loss)

As a result of the foregoing, the Company's net income for the year ended December 31, 2005 was $12.1 million, as compared to net loss of $10.9 million for year ended December 31, 2004.

CONTRACTUAL OBLIGATIONS

A summary of long-term contractual obligations as of December 31, 2006 follows. The amounts represent estimates of gross undiscounted amounts payable over time.

	(Dollars in Thousands)				
	Total	2007	2008-2009	2010-2011	After 2011
Contractual Obligations					
Operating leases	$ 1,944	$ 601	$ 1,238	$ 105	$ -
Subordinated debt	4,167	4,167	-	-	-
Total	$ 6,111	$ 4,768	$ 1,238	$ 105	$ -

LIQUIDITY AND CAPITAL RESOURCES

For the year ended December 31, 2006, our primary sources of capital were revenues generated from operations, including decreased amounts due from reinsurers, net, increased unearned premiums and decreased finance contracts receivable. Operational sources of capital also included, decreased other assets, increased premium deposits and customer credit balances, increased accounts payable, net realized investment gains, non-cash compensation, premiums receivable, depreciation and amortization, common stock issued for interest on notes, and an increased provision for credit losses. Also contributing to our liquidity were proceeds from the sale of investment securities, exercised warrants, the sale of assets, exercised employee stock options and a tax benefit related to non-cash compensation. Because we are a holding company, we are largely dependent upon fees and commissions from our subsidiaries for cash flow.

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For the year ended December 31, 2006, operations provided net operating cash flow of $27.5 million, as compared to $19.4 million for year ended December 31, 2005.

For the year ended December 31, 2006, operations generated $184.6 million of gross cash flow, due to a $140.9 million decrease in amounts due from reinsurers, net, a $16.0 million increase in unearned premiums, a $5.5 million decrease in finance contracts receivable, a $2.5 million decrease in other assets, a $1.6 million increase in accounts payable and accrued expenses, a $1.6 million increase in premium deposits and customer credit balances and $1.1 million of net realized investment gains.

For the year ended December 31, 2006, operations used $156.9 million of gross cash flow primarily due to a $114.4 million decrease in unpaid losses and LAE, a $26.8 million increase in prepaid reinsurance premiums, a $4.1 million decrease in bank overdrafts, a $3.0 million decrease in income taxes payable, a $2.4 million increase in deferred gain on sale of our building, a $2.0 million increase in policy acquisition costs, net of amortization, a $1.5 million decrease in funds held under reinsurance treaties, a $0.9 million increase in deferred income tax expense, $0.8 million increase in income taxes recoverable, a $0.6 million increase in recognized gain in connection with the sale of our building, $0.3 million in amortization of investment discount, net and a $0.1 million recovery of uncollectible premiums receivable.

Subject to catastrophic occurrences, net operating cash flow is currently expected to be positive in both the short-term and the reasonably foreseeable future.

For the year ended December 31, 2006, net investing activities used $19.7 million, as compared to $15.5 million for the year ended December 31, 2005. Our available for sale investment portfolio is highly liquid as it consists entirely of readily marketable securities.

For the year ended December 31, 2006, investing activities generated $276.9 million and used $296.6 million from the maturity several times over of our very short municipal portfolio. Sources of cash flow from investing activities included the sale of property with net book value of $2.7 million, for which we received $5.6 million in proceeds and recorded a $2.9 million deferred gain. The Company also used $0.4 million for the purchase of equipment.

For the year ended December 31, 2006, net financing activities provided $4.0 million, as compared to using $4.0 million for the year ended December 31, 2005. For the year ended December 31, 2006, the sources of cash in connection with financing activities included $10.7 million from the exercise of warrants, $2.6 million from the exercise of stock options and a $1.6 million tax benefit related to non-cash compensation. The uses of cash in connection with financing activities included $4.4 million for the regularly scheduled principal and interest payments on our Notes, $4.3 million in dividends paid, $2.0 million for the acquisition of common stock and $0.2 million in connection with the reduction of our outstanding revolving credit.

Federated Premium's operations are partially funded by the revolving loan agreement with FlatIron. The effective interest rate on this line of credit, based on our average outstanding borrowings under the Revolving Agreement, was 7.82%, 6.39%, and 5.71% for the years ended December 31, 2006, 2005, and 2004, respectively. Interest expense on this revolving credit line for the years ended December 31, 2006, 2005, and 2004 totaled approximately $8,000 $75,000, and $178,000, respectively.

Outstanding borrowings under the Revolving Agreement as of December 31, 2006 were approximately $0.01 million, as compared to $0.2 million as of December 31, 2005.

As an alternative to premium finance, we offer direct billing in connection with our automobile program, where the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring the full amount of the policy, either directly from the insured or from a premium finance company. The advantage of direct billing a policyholder by the insurance company is that we are not reliant on our credit facility, but remain able to charge and collect interest from the policyholder.

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We believe that our current capital resources, together with cash flow from operations, will be sufficient to meet currently anticipated working capital requirements. There can be no assurances, however, that such will be the case.

Federated National's and American Vehicle's statutory capital surplus levels as of December 31, 2005 were approximately $11.2 million and $18.0 million, respectively, and their statutory net income (loss) for the year ended December 31, 2005 were ($2.2) million and $2.9 million, respectively.

As of December 31, 2006, 2005, and 2004, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as "structured finance" or "special purpose" entities, which were established for the purpose of facilitating off-balance-sheet arrangements or other contractually narrow or limited purposes. As such, management believes that we currently are not exposed to any financing, liquidity, market or credit risks that could arise if we had engaged in transactions of that type requiring disclosure herein.

On July 31, 2003, we completed a private placement of our 6% Senior Subordinated Notes (the "July 2003 Notes"), which were offered and sold to accredited investors as units consisting of one July 2003 Note with a principal amount of $1,000 and warrants (the "2003 Warrants") to purchase shares of our Common Stock. We sold an aggregate of $7.5 million of July 2003 Notes in this placement, which resulted in proceeds to us (net of placement agent fees of $450,724 and offering expenses of $110,778) of $6,938,498.

The July 2003 Notes paid interest at the annual rate of 6%, were subordinated to senior debt of the Company, and matured on July 31, 2006. Quarterly payments of principal and interest due on the July 2003 Notes were made in cash or, at our option, in shares of our Common Stock. When paid in shares of Common Stock, the number of shares issued was determined by dividing the payment due by 95% of the weighted-average volume price for the Common Stock on Nasdaq as reported by Bloomberg for the 20 consecutive trading days preceding the payment date.

The 2003 Warrants issued in this placement to the purchasers of the July 2003 Notes and to the placement agent in the offering, J. Giordano Securities Group ("J. Giordano"), each entitled the holder to purchase ¾ of one share of our Common Stock at an exercise price of $12.744 per whole share (as adjusted for the Company's three-for-two stock split) until July 31, 2006. The total number of shares issuable upon exercise of 2003 Warrants issued to the purchasers of the July 2003 Notes and to J. Giordano totaled 612,074. GAAP required that detachable warrants be valued separately from debt and included in paid-in capital. Based on the terms of the purchase agreement with the investors in the private placement, management determined that the July 2003 Warrants had zero value at the date of issuance.

On July 31, 2006, we made the final principal payment of $625,000 on the July 2003 notes and the July 2003 warrants expired. Of the 612,074 shares that could have been issued in connection with the July 2003 warrants, 301,430 were exercised, 225,000 were reacquired in the open market by us and 85,644 were unexercised. The unexercised warrants were cancelled as of July 31, 2006.

On September 30, 2004, we completed a private placement of 6% Senior Subordinated Notes due September 30, 2007 (the "September 2004 Notes"). These notes were offered and sold to accredited investors as units consisting of one September 2004 Note with a principal amount of $1,000 and warrants to purchase shares of our Common Stock (the "2004 Warrants"), the terms of which are similar to our July 2003 Notes and 2003 Warrants, except as described below. We sold an aggregate of $12.5 million of units in this placement, which resulted in proceeds (net of placement agent fees of $700,000 and offering expenses of $32,500) to us of $11,767,500.

The September 2004 Notes pay interest at the annual rate of 6%, mature on September 30, 2007, and rank pari passu in terms of payment and priority to the July 2003 Notes. Quarterly payments of principal and interest due on the

September 2004 Notes, like the July 2003 Notes, may be made in cash or, at our option, in shares of our Common Stock. If paid in shares of Common Stock, the number of shares to be issued shall be determined by dividing the payment due by 95% of the weighted-average volume price for the Common Stock on Nasdaq as reported by Bloomberg for the 20 consecutive trading days preceding the payment date.

The 2004 Warrants issued to the purchasers of the September 2004 Notes and to the placement agent in the offering, J. Giordano, each entitle the holder to purchase one share of our Common Stock at an exercise price of $12.75 per share and will be exercisable until September 30, 2007. The number of shares issuable upon exercise of the 2004 Warrants issued to purchasers equaled $12.5 million divided by the exercise price of the warrants, and totaled 980,392. The number of shares issuable upon exercise of the 2004 Warrants issued to J. Giordano equaled $500,000 divided by the exercise price of the warrants, and totaled 39,216. GAAP requires that detachable warrants be valued separately from debt and included in paid-in capital. Based on the terms of the purchase agreement with the investors in the private placement, management determined that the September 2004 Warrants had zero value at the date of issuance. Of the 1,019,000 warrants issued in connection with the September 2004 notes, 751,699 have been exercised to date.

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The terms of the 2004 and 2003 Warrants provide for adjustment of the exercise price and the number of shares issuable thereunder upon the occurrence of certain events typical for private offerings of this type.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and related data presented herein have been prepared in accordance with GAAP which requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the inflationary effect on the cost of paying losses and LAE.

Insurance premiums are established before we know the amount of loss and LAE and the extent to which inflation may affect such expenses. Consequently, we attempt to anticipate the future impact of inflation when establishing rate levels. While we attempt to charge adequate premiums, we may be limited in raising premium levels for competitive and regulatory reasons. Inflation also affects the market value of our investment portfolio and the investment rate of return. Any future economic changes which result in prolonged and increasing levels of inflation could cause increases in the dollar amount of incurred loss and LAE and thereby materially adversely affect future liability requirements.

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SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

	Year Ended December 31, 2006 (Dollars in Thousands except EPS)			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue:				
Net premiums earned	$ 21,807	$ 28,741	$ 21,707	$ 17,093
Other revenue	3,307	3,601	3,063	4,595
Total revenue	25,114	32,342	24,770	21,688
Expenses:				
Losses and LAE	7,569	9,343	10,271	17,217
Other expenses	8,289	8,389	10,613	10,931
Total expenses	15,858	17,732	20,884	28,148
Income (loss) before provision (benefit) for income tax expense	9,256	14,610	3,886	(6,460)
Provision (benefit) for income tax expense	3,243	5,705	857	(2,409)
Net income	$ 6,013	$ 8,905	$ 3,029	$ (4,051)
Basic net income per share	$ 0.88	$ 1.20	$ 0.40	$ (0.52)
Fully diluted net income per share	$ 0.83	$ 1.19	$ 0.40	$ (0.52)
Weighted average number of common shares outstanding	6,845	7,428	7,561	7,846
Weighted average number of common shares outstanding (assuming dilution)	7,238	7,466	7,563	7,846

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	Year Ended December 31, 2005 (Dollars in Thousands except EPS)			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Continuing Operations:				
Revenue:				
Net premiums earned	$ 18,835	$ 21,889	$ 20,702	$ 21,537
Other revenue	3,032	2,756	2,953	2,964
Total revenue	21,867	24,646	23,656	24,502
Expenses:				
Losses and LAE	6,910	12,309	13,276	15,842
Other expenses	7,417	7,389	7,443	8,314
Total expenses	14,327	19,697	20,719	24,156
Income from continuing operations before provision (benefit) for income tax expense	7,540	4,948	2,937	346
Provision (benefit) for income tax expense	2,754	1,925	1,084	(1,073)
Net income from continuing operations	4,786	3,024	1,853	1,419
Discontinued Operations:				
Gain on sale of discontinued operations	1,630	-	-	-
Income from discontinued operations before provision for income tax expense	1,630	-	-	-
Provision for income tax expense	595	-	-	-
Net income from discontinued operations	1,035	-	-	-
Income before provision (benefit) for income tax expense	9,170	4,948	2,937	346
Provision (benefit) for income tax expense	3,349	1,925	1,084	(1,073)
Net income	$ 5,820	$ 3,024	$ 1,853	$ 1,419
Basic net income per share from continuing operations	$ 0.78	$ 0.48	$ 0.29	$ 0.22
Basic net income per share from discontinued operations	$ 0.17	$ -	$ -	$ -

Basic net income per share	$	0.95	$	0.48	$	0.29	$	0.22
Fully diluted net income per share from continuing operations	$	0.73	$	0.46	$	0.28	$	0.21
Fully diluted net income per share from discontinued operations	$	0.16	$	-	$	-	$	-
Fully diluted net income per share	$	0.89	$	0.46	$	0.28	$	0.21
Weighted average number of common shares outstanding		6,153		6,349		6,384		6,502
Weighted average number of common shares outstanding (assuming dilution)		6,532		6,621		6,589		6,873

OFF BALANCE SHEET TRANSACTIONS

For the years ended December 31, 2006 and 2005, there were no off balance sheet transactions.

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ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Our investment objective is to maximize total rate of return after Federal income taxes while maintaining liquidity and minimizing risk. Our current investment policy limits investment in non-investment grade fixed maturity securities (including high-yield bonds), and limits total investments in preferred stock, common stock and mortgage notes receivable. We also comply with applicable laws and regulations, which further restrict the type, quality and concentration of investments. In general, these laws and regulations permit investments, within specified limits and subject to certain qualifications, in Federal, state and municipal obligations, corporate bonds, preferred and common equity securities and real estate mortgages.

Our investment policy is established by the Board of Directors or the Investment Committee and is reviewed on a regular basis. Pursuant to this investment policy, as of December 31, 2006, approximately 89.4% of investments were in fixed income securities and short-term investments, which are considered to be either held until maturity or available for sale, based upon our estimates of required liquidity. Approximately 80% of the fixed maturities are considered available for sale and are marked to market. We may in the future consider additional fixed maturities to be held to maturity and carried at amortized cost. We do not use any swaps, options, futures or forward contracts to hedge or enhance our investment portfolio.

The investment portfolio is managed by the Investment Committee consisting of all current directors in accordance with guidelines established by the Florida OIR.

The table below sets forth investment results for the periods indicated.

	Years Ended December 31,		
	2006	2005	2004
	(Dollars in Thousands)		
Interest on fixed maturities	$ 4,618	$ 2,970	$ 2,437
Dividends on equity securities	623		